
President Clinton's 1998 Budget

A Brief Overview



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GENERAL NOTES

- (1) In this document, all dollar and percentage amounts relating to the President's budget and to current services estimates have been taken from the President's 1998 budget document. These figures are based on the President's economic forecast and technical estimating procedures and have not been reestimated by the Congressional Budget Office.
- (2) "BEA" refers to the Budget Enforcement Act, Title XIII of the Omnibus Budget Reconciliation Act of 1990.
- (3) Unless otherwise stated, all years in this report are fiscal years.
- (4) In the case of all tables: (a) Details may not add to totals due to rounding; (b) "N/A" means not available or not applicable; and (c) "(*)" means less than \$0.5 billion, less than \$500,000 or less than one-half percent.

OVERVIEW

THE PRESIDENT'S "BRIDGE" TO THE FUTURE

For many in Congress the President's 1998 budget plan will answer the question as to whether he is serious about building a solid bridge to the future. For them the answer will be easy -- no! Others, however, will recognize that the stakes are too high and the risks too great, if they do not at least attempt to build on an otherwise flawed plan.

Senate Budget Committee Chairman Pete Domenici has recently conducted a series of hearings highlighting the challenges facing the country "beyond the bridge." Those hearings have concluded that the time is now to confront the looming fiscal imbalances that will confront us early in the next century.

This brief overview of the President's 1998 budget is not meant to distract from the goals and objectives outlined in that document. For after all, the premier goal of achieving balance in 2002, providing tax relief to families, protecting and preserving the Medicare program, insuring adequate funding for our national defense, and more -- Republicans support. Rather this review asks whether the long-term challenges are being addressed, do weaknesses exist and are there dangers ahead. Only by recognizing these weaknesses can a true bipartisan effort be launched to correct them and build a solid bridge to the future.

Bridge Construction Ahead

The cost of the President's 1998 bridge to the 21st century, paid in five installments will total \$8.987 trillion. Tolls and revenues to pay for the bridge will exceed \$8.642 trillion, so lenders will still have to buy "bridge bonds" of nearly \$345 billion over the next five years to complete its construction. Interestingly, when the President submitted his 1997 budget to Congress one year ago, the cost of the same five-year bridge span was \$8.985 trillion, almost identical to this year's cost. *Despite much talk of reducing spending, the President's five-year costs of government are almost identical to what they were a year ago. More alarming, the budget deficit over the next five years is nearly \$200 billion higher than what was proposed by the President a year ago.*

Federal spending would increase each year, growing from \$1.6 trillion this year to nearly \$1.9 trillion in 2002. The President proposes to increase spending 3.5 percent in 1998, down

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from 4.6 percent last year. Over the period from last year to 2002 spending would grow at an average annual rate of about 3.2 percent. The President's own submission acknowledges that the deficit will increase, from an estimated \$107 billion in 1996 to \$121 billion in 1998. The deficit would not start declining until 1999 and would, using the President's assumptions, reach a small surplus in 2002.

PRESIDENT'S BUDGET FOR 1998 (\$ Billions)

	1996 Actual	1997	1998	1999	2000	2001	2002
Spending	1,560	1,631	1,688	1,761	1,814	1,845	1,880
Revenues	1,453	1,505	1,567	1,643	1,727	1,808	1,897
Deficit/Surplus	-107	-126	-121	-117	-87	-36	+17
Debt subject to limit	5,137	5,411	5,697	5,973	6,233	6,447	6,614

The President's budget claims, that he would reduce spending for federal programs from what would have occurred without any legislative action by nearly \$260 billion over the next five years. These savings are derived from: (1) \$80 billion less defense spending than what would have occurred had the actual funding level in 1997 grown by inflation; (2) \$58 billion less spending on annually appropriated domestic programs, again from what would have been spent had their 1997 funding level grown by inflation; and (3) \$121 billion less net spending on entitlement programs, from what would have been spent if the programs remained unchanged.

However, while slowing the rate of growth in some areas, the President creates nearly \$60 billion in new entitlement spending. The President proposes nearly \$15 billion in new Medicare benefits, \$5 billion more Medicaid benefits for children, \$10 billion in health care benefits for unemployed adults, \$4 billion in health care benefits to children not receiving Medicaid, \$6.2 billion in school construction and other education entitlement benefits, \$21.3 billion more food stamps, SSI, employment and other welfare reform related benefits. New and expanded entitlements, while politically popular, nonetheless can create serious risk to future spending patterns early in the next century.

In addition, requested but not included in the President's numbers is an annual appropriation of \$5.8 billion to fund emergency disaster assistance provided by FEMA, Agriculture, Interior, Transportation, SBA, and the Corp of Engineers. In other words, nearly \$30 billion in very likely spending over the next five years has not even been included in the President's forecasts. Further, the President proposes to allow \$47 billion in new or increased user fees and other collections to offset discretionary spending. While the President's proposal is

intended to tie these fees to the service provided, this proposal also allows for more not less government activity.

Federal revenues would increase from an estimated \$1.5 trillion this year to nearly \$1.9 trillion in 1997 to \$1.9 trillion in 2002, under the President's assumptions. From last year to 2002 revenues would grow at an annual rate of nearly 4.5 percent. The President's budget does propose legislation to reduce the growth rate of taxes by \$98.5 billion over the next five years. Ninety percent of these tax reductions fall in three areas: (1) \$46 billion for tax credits to families with dependent children, (2) \$36 billion for education and training tax benefits, and (3) expanded IRA accounts.

However, the President's budget also proposes to eliminate \$34 billion in "unwarranted tax benefits" primarily focused on corporations and businesses. Further, the President proposes to raise \$42 billion by extending and modifying various tax raising provisions that have expired. The single largest of these extenders would be an extension of the expired airline excise tax accounting for \$32.2 billion of the "extenders."

Counting tax cuts and tax increases together, the President's budget reduces revenues on the overall economy by only \$22.4 billion over the next five years.

SUMMARY OF PRESIDENT'S BUDGET FOR 1998

(\$ Billions)

	1997	1998	1999	2000	2001	2002	Total
Current services deficits	127.7	119.5	140.1	127.6	108.5	100.8	
Discretionary:							
Defense	-0.7	-5.3	-14.6	-14.4	-21.9	-23.2	-79.5
Nondefense	+(*)	-0.6	-3.3	-8.3	-18.8	-27.0	-58.0
Mandatory:							
Medicare	--	-4.3	-11.4	-22.2	-27.8	-34.6	-100.2
Medicaid	--	1.4	0.4	-1.4	-3.9	-5.8	-9.3
Other mandatory	0.3	3.0	5.4	4.2	-0.9	-23.4	-11.4
Net tax cut	-1.6	7.0	1.4	3.7	5.5	4.9	22.4
Debt service	-0.1	-0.1	-0.7	-2.1	-4.5	-8.5	-15.9
Total deficit reduction	-2.1	1.1	-22.7	-40.5	-72.3	-117.7	-252.1
Resulting deficit/surplus	125.6	120.6	117.4	87.1	36.1	-17.0	

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AGGREGATE BUDGET TOTALS (\$ Billions)

	1997	1998	1999	2000	2001	2002	Total
Discretionary:							
Defense	268	260	262	268	269	274	1,332
Nondefense	282	287	295	296	292	293	1,465
Subtotal	550	548	558	564	561	567	2,797
Mandatory:							
Medicare	192	204	217	227	243	261	1,152
Medicaid	99	106	112	118	125	133	594
Social Security	364	381	399	418	438	460	2,095
Other mandatory	179	199	224	240	232	220	1,115
Subtotal	834	890	951	1,002	1,039	1,074	4,956
Net interest	247	250	252	248	245	239	1,234
Total spending	1,631	1,688	1,761	1,814	1,845	1,880	8,987
Revenues	1,505	1,567	1,643	1,727	1,808	1,897	8,642
Deficit/surplus	-126	-121	-117	-87	-36	17	

Danger: Unfinished Bridge Span Ahead

The President's 1998 budget plan, as in the past, will not reach balance in 2002 using the more conservative economic outlook of the Congressional Budget Office (CBO). Only, by relying on a proposed mechanical legislative across-the-board spending reduction and tax cut shut off -- triggers -- as proposed in the President's budget would balance be achieved in 2002 using the CBO economic forecast.

While uncertainty exists in any economic forecast, considering the demographic and fiscal challenges facing the country in the next century from an aging population, the more conservative CBO economic forecast would normally be preferred. Using those forecasts, the CBO estimates that the deficits over the next five years will be nearly \$190 billion higher than what the President has used to produce his budget. In 2002 alone, the deficit would be \$66 billion higher under the CBO forecast.

Therefore, the President is able to reach balance in 2002 with significantly less policy changes and more spending flexibility than what would be required using the CBO forecast. On net, the President reaches balance in 2002 with less than \$258 billion in reduced spending. Using

the more conservative CBO forecast reduced spending of nearly \$450 billion would be required to achieve balance and provide higher net tax relief to the economy.

COMPARISON OF BASELINE DEFICITS
(\$ Billions)

	1997	1998	1999	2000	2001	2002	Total
OMB	127.7	119.5	140.1	127.6	108.5	100.8	
CBO	124.1	134.9	157.9	175.3	152.5	166.6	
Difference	+3.6	-15.4	-17.8	-47.7	-44.0	-65.8	-187.1

Hard Hats Required: The Challenge Ahead

The President's 1998 budget plan represents a major challenge to all. It is a challenge to the Congress to find a way to remodel the plan to reflect their constituents' priorities while at the same time not jeopardizing the common objective of achieving balance in 2002. It represents a challenge to the President and his Administration to modify their stated priorities, examine their economic assumptions, and compromise with those in Congress who also desire a better future for the country by ceasing to avoid the hard choice that must be made soon.

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ECONOMICS

The economy closed 1996 on a strong note, with a spurt in the fourth quarter pushing year over year GDP growth to 2.5 percent. However, while the economic outlook looks robust at the moment, there are concerns that this pace will not continue for the next six years. Unemployment remains at levels which have historically led to rising inflation. Given the lags involved, it is possible that such a backdrop may force the Federal Reserve to tighten monetary policy early in the year. Such a move would exacerbate an expected slowdown in capital investment.

Private sector economists share these concerns. A recent Blue Chip survey showed that 62 percent of economists surveyed expect a recession before 1999. With CBO simulations showing the large impact that any such slowdown could have on budget numbers, conservative economic forecasts should be considered for budgeting purposes. Unfortunately, OMB does not seem to agree.

I : Economic Overview

The current economic expansion is now in its sixth year, making it the third longest on record. If it continues until the end of the budget window, it will be the longest expansion in history at 141 months. This easily beats the 1960's prior record of 106 months.

There are some reasons to expect that expansions may last longer in today's environment. The Federal Reserve is keeping inflation low and stable, the economy is more open and de-regulated, and firms have become much more efficient managers of their inventories. However, it would be presumptuous to suggest that the business cycle has been vanquished. The economy is always vulnerable to an outside shock, and with consumer debt levels high and business investment likely to slow, the impact could be more pronounced at this advanced stage of the economic cycle.

II : CBO : Budget Impact from Recession

Given the risks of recession sometime before 2002, CBO completed a study recently which examined the potential impact of a recession on budget projections and the goal of a balanced budget by 2002.

CBO examined two scenarios -- a recession in 1998 and one in 2000. Both cases assume a recession on par with that of 1990/1991, which would see GDP fall 3.7 percent below potential. Such a slowdown would add roughly \$100 billion onto the deficit two years after the recession began. In either scenario, the recession would make the goal of a balanced budget in 2002 very difficult: a 1998 recession would add \$30 billion to the deficit in 2002, while a 2000 recession would leave a gaping \$100 billion fiscal hole in 2002.

III : The Administration's Economic Forecasts

Despite the likelihood of a recession at some point during the budget window, OMB has ignored this risk and produced a set of economic assumptions that generate rosy deficit projections. While the numeric differences between CBO and OMB economics may appear small, they create a \$60+ billion gap between OMB's and CBO's deficit projections in 2002 alone.

At first glance, OMB's forecasts may seem similar to Blue Chip's, barring OMB's exceptionally low long-term interest rate projections. Yet, the big dollar differences do not stem from the most commonly quoted economic indices, but rather from less publicized statistics like income shares and the spread between CPI and the GDP deflator.

A) Corporate Profit Shares

The largest source of difference stems from corporate profit shares. Despite downward revisions to its forecasts in August 1996 and January 1997, OMB still has an unreasonably high path of projected corporate profits. If one looks at the average, forecasted profit share during 1997-2002, OMB's is 0.6 percentage points higher than CBO. Furthermore, OMB is at least 0.6 percentage points above those of the major private forecasters (DRI and Macroeconomic Advisers).

Corporate profit shares are very important to budget projections since profits are more highly taxed than other forms of income: the higher the projected profit shares, the higher the revenue stream and the lower the deficit.

Why have other forecasters adopted more conservative pathways for corporate profits? One key reason is the risk of recession. Corporate profits have been exceptionally strong in recent years, however, most forecasters now expect profit growth to ease back, given the advanced stage of the economic expansion. This slowing would be even more pronounced, should a recession hit within the budget window. There is another reason to be skeptical about high corporate profit shares in the budget window, as well. Companies are likely to increase their debt issuance in coming years, as they revert to historical trend. This implies that more income will be paid out in the form of interest income. This will hurt revenues overall since interest income is less likely to be taxed than corporate profits.

B) Wage and Salary Shares

OMB has fairly steady wage and salary share forecasts. However, we believe that CBO's downward sloping projections are a better reflection of upcoming trends. First, the share of nontaxable benefits to GDP is likely to grow in coming years, which will reduce wage and salary's share of GDP. While the shift to managed health care has held back employees' benefits costs in recent years, this is unlikely to be a permanent phenomenon. Secondly, an expected narrowing of the statistical discrepancy between the NIPA's income and product accounts should also place downward pressure on the main taxable categories of income shares. (Recently, the statistical discrepancy has inflated the income side of the accounts relative to the product side).

C) CPI - GDP Deflator Spread

Another main source of difference between CBO and OMB economics deals with the gap between CPI and the GDP deflator. Since indexed outlays are linked mainly to CPI while revenue projections are based off of the GDP deflator, budget forecasts look better the lower CPI is in relation to the GDP deflator.

Historically, CPI has averaged 0.4 percentage points above the GDP deflator, during the period from 1965 to 1996. Indeed, in 1996 alone, CPI was 0.8 percentage points higher. (This historical gap is not solely a function of CPI bias -- the overall deflator surveys many goods which are outside the consumer sector). Despite extensive historical data to the contrary, OMB has forecasted a CPI - deflator gap that averages only 0.1 percent between 1997 and 2002. In contrast, CBO and DRI look for a more historically consistent 0.4 percent gap.

OMB has similar GDP deflators to CBO, but has markedly lower CPI forecasts. Note, the differences in CPI forecasts are not due to differing assumptions over BLS technical changes to CPI, but rather stem from differing macroeconomic assumptions. OMB's compression of the CPI - deflator spread is a rich source of quick budget savings.

IV : CPI Bias

Following the release of the Boskin Commission's report last December, there has been considerable debate as to whether CPI overstates the true cost of living. While a legislative reduction of CPI has been suggested by various groups, the President's budget makes no such assumptions.

However, OMB's economic forecasts do reflect three changes to CPI that BLS has either implemented recently or has announced will occur within the budget window. Firstly, OMB adjusts for July 1996's correction of the so-called 'formula bias' problem. This shaved 0.1 percent off of CPI. CBO also reflects this change in their CPI forecasts.

Secondly, OMB has built in expected CPI changes stemming from BLS' January 1997 changes in hospital pricing. OMB expects this to reduce CPI by roughly 0.1 percent. CBO assumes this medical change will reduce overall CPI by a fractional amount. The differences between OMB and CBO on this issue are trivial.

Thirdly, OMB adjusts for the 1998 reweighting of the CPI basket, which will make CPI more reflective of current consumer spending patterns. Since consumers are constantly switching to lower cost goods when relative prices change, a more updated basket is expected to reduce CPI's growth rate slightly beginning in 1998. However, this will be only a temporary reduction, because renewed bias will creep in the farther one gets from 1998 and the more outdated the consumer basket becomes. OMB assumes that the basket reweighting will shave off 0.1 percent from CPI during the budget window. CBO assumes a 0.2 percent reduction in 1998 from this BLS action. However, CBO also assumes that renewed upward bias quickly pares this adjustment back as one nears 2002. As such, over the entire budget window, CBO's and OMB's assumptions are very similar concerning the 1998 basket reweighting.

All told, OMB assumes that the CPI changes BLS has actually made or has promised since spring 1996, total 0.3 percent. CBO has similar assumptions built into their economic forecasts.

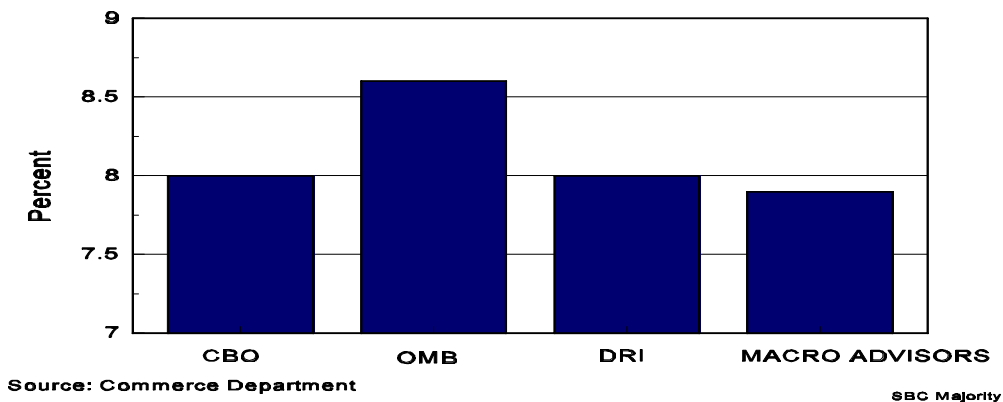
V : Long-Term Outlook

Both OMB and CBO assume there will be an improvement in economic growth if the budget is balanced by 2002. The main driver for such thinking is the expected drop in long-term interest rates as deficits decline. While reduced debt issuance between 1997-2002 is certainly a positive, financial markets will be reluctant to bid down long-term rates aggressively unless they believe that the fiscal improvement will be lasting. Indeed, CBO has said as much, arguing in its "Economic and Budget Outlook: FY 1997-2006" that the economic outlook would only improve if the budget is balanced in 2002 and thereafter. Most have lost sight of the fact that the fiscal dividend is only awarded if budgets are balanced permanently and not just for a nanosecond in 2002.

Without meaningful changes in entitlement spending over the next several years, however, deficits will renew their upward climb beyond 2002 as the baby-boomers age. Without significant policy changes, the US debt to GNP ratio will soar by 2020, according to recent CBO long-term projections. So long as financial markets are wary of such a potential, long-term fiscal meltdown, both OMB and CBO interest rate projections may prove to be too optimistic over the budget window. Thus, maintenance of post-policy economics is dependent not just upon achieving a balanced budget in 2002, but achieving one which gets there via significant changes in entitlement spending and avoids short-term budgetary shell games.

Corporate Profit Share Forecasts

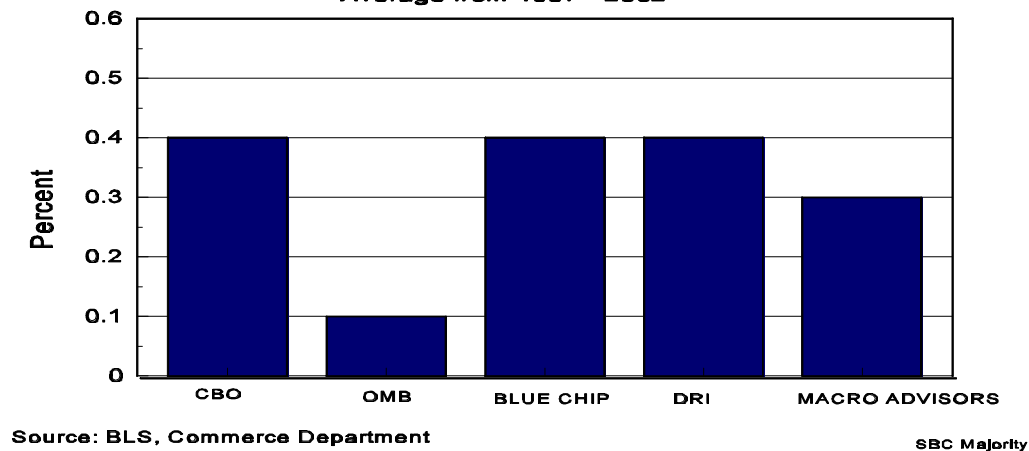
Average of 1997 - 2002



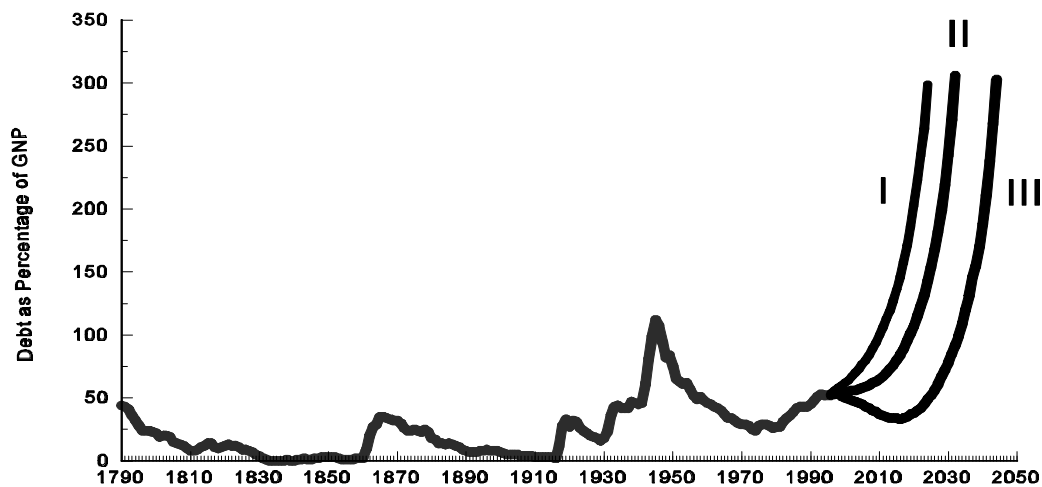
* Forecasts are contained in : CBO's "The Economic and Budget Outlook : FY1998-2007", OMB's FY 1998 budget, DRI's January 1997 forecast (for 1997-2001), Macroeconomic Advisers' January 1997 forecast.

Spread Between CPI & GDP Deflator Forecasts

Average from 1997 - 2002



Projections of Debt-to-GNP Ratios



Notes: Simulations I, II, and III are based on different population and productivity growths.
Simulation II is a base case.
Assumes discretionary spending grows with inflation after 2006.
Source: Senate Budget Committee, Majority Staff; based on data supplied by CBO.

** Forecasts are contained in : CBO's "The Economic and Budget Outlook : FY1998-2007", OMB's FY 1998 budget, Blue Chip Economic Indicators October 1996 and January 1997, DRI's January 1997 forecast (for 1997-2001), Macroeconomic Advisers' January 1997 forecast.

ECONOMIC PROJECTIONS COMPARISON
(Post Policy; Calendar Years)

	1997	1998	1999	2000	2001	2002
Percent Change (Year to Year):						
Nominal GDP Growth						
Administration*.....	4.8	4.7	4.9	5.0	5.0	5.0
CBO*.....	4.6	4.6	4.9	4.9	4.8	4.8
Blue Chip*.....	4.6	4.6	4.5	5.0	5.0	5.0
Real GDP Growth						
Administration.....	2.2	2.0	2.2	2.3	2.3	2.3
CBO.....	2.3	2.1	2.2	2.2	2.2	2.1
Blue Chip.....	2.3	2.1	1.9	2.5	2.4	2.3
Consumer Price Index						
Administration.....	2.7	2.7	2.7	2.7	2.7	2.7
CBO.....	2.9	2.9	3.0	3.0	3.0	3.0
Blue Chip.....	2.9	3.0	3.0	2.8	2.9	3.0
GDP Price Deflator						
Administration.....	2.5	2.6	2.6	2.6	2.6	2.6
CBO.....	2.3	2.5	2.6	2.6	2.6	2.6
Blue Chip.....	2.3	2.5	2.6	2.5	2.6	2.6
Annual Rate:						
Unemployment						
Administration.....	5.3	5.5	5.5	5.5	5.5	5.5
CBO.....	5.3	5.6	5.8	5.9	6.0	6.0
Blue Chip.....	5.4	5.5	6.0	5.9	5.8	5.7
Three-Month T-Bill						
Administration.....	5.0	4.7	4.4	4.2	4.0	4.0
CBO.....	5.0	5.0	4.6	4.2	3.9	3.9
Blue Chip.....	5.2	5.1	5.1	5.0	5.0	5.1
Ten-Year T-Note						
Administration.....	6.1	5.9	5.5	5.3	5.1	5.1
CBO.....	6.2	6.1	5.8	5.5	5.5	5.5
Blue Chip.....	6.4	6.4	6.4	6.4	6.4	6.5
Share of GDP:						
Corporate Profits (Book Profits)						
Administration.....	8.5	8.6	8.7	8.7	8.5	8.4
CBO.....	8.2	8.1	7.9	7.8	7.8	7.8

*Administration is from President's FY 1998 Budget. CBO is from CBO's "Economic and Budget Outlook: Fiscal Years 1998 - 2007." Blue Chip Economic Indicators published October 1996 and January 1997.

BUDGET BY FUNCTION

FUNCTION 050: NATIONAL DEFENSE

The Administration has requested \$265.3 billion in total budget authority and \$259.4 in total outlays for the National Defense budget function (050) in 1998. The 1998 request is \$2.9 billion in budget authority below last year's Congressional Budget Resolution level for 1998, and it is \$3.6 billion below the Budget Resolution in outlays. This function includes the Department of Defense (DOD) in subfunction 051, Atomic Energy Defense Activities (AEDA) in the Department of Energy (DOE) in subfunction 053, and other defense related activities in the Federal Emergency Management Agency, the Selective Service, the General Services Administration, and other federal agencies in subfunction 054¹.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	266.0	262.3	265.3	269.2	275.0	281.5	289.1
Outlays	265.7	267.2	259.4	261.4	267.2	268.0	273.2
Change from 1997:							
Budget authority	---	---	3.0	6.9	12.7	19.2	26.8
Outlays	---	---	-7.8	-5.8	0.0	0.8	6.0
FY 1997 Budget Resolution							
Budget authority	---	265.6	268.2	270.8	273.3	276.0	278.8
Outlays	---	264.1	263.0	266.3	270.0	269.0	269.0

The President's National Defense Spending Increases

- ▶ The President's budget request for national defense for 1998 and for the period 1998 - 2002 is substantially higher than the plan he submitted last year for the same time period. The Clinton Administration's 1997 plan projected \$258.5 billion in budget authority for 1998; now the 1998 request is for \$265.3 billion -- \$6.8 billion higher. For the period

¹Subfunction 052 related to the Foreign Military Sales program and was transferred to Function 150 (International Affairs).

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1998 - 2002, last year's Presidential plan projected a total of \$1,359.8 billion in budget authority; the new plan projects a total of \$1,380.1 billion, an increase of \$20.3 billion.

- ▶ The President's defense request for 1998 - 2002 **exceeds** the budget authority assumed last year by the Congressional Budget Resolution by \$13.0 billion. On the other hand, the President's 1998 - 2002 plan is \$8.1 billion **lower** than the Congressional Budget Resolution in outlays. The budget authority increases being sought by the President are a major change from his concern last year that the Congressional Budget Resolution's national defense spending levels were "unaffordable." However, the Administration has budgeted significantly fewer outlays than budget authority over the long term, and this could prove to be a cause for concern. It will be an area of special focus for those who have their highest priorities in DOD's rapidly spending accounts, such as Operations and Maintenance and Military Personnel, which are intended to support an adequate "quality of life" for Armed Forces personnel.
- ▶ The President's request for budget authority for 1998 is also \$3.0 billion more than the 1997 appropriations level; however, parallel to the concern about long term outlays expressed above, the President's request for outlays for 1998 would be a reduction of \$7.8 billion from 1997.

Department of Defense

- ▶ The 1998 request for the Department of Defense (subfunction 051) proposes \$250.7 billion in discretionary budget authority and \$247.5 billion in discretionary outlays. Compared to the 1997 final appropriations, **DOD budget authority would increase \$700 million in nominal dollars; outlays would decline \$6.8 billion. Adjusted for inflation, the 1998 request is 30 percent below the 1985 level; this defense budget request is the thirteenth straight year of real decline -- that is, if the purchasing power of dollars is held constant over time.**
- ▶ Procurement spending **declines from \$44.1 billion in 1997 to \$42.6 in 1998, a reduction of \$1.5 billion. Since 1985, this account has been cut from \$134.3 billion, in constant dollars, a 70 percent reduction.** For the past three years, the Administration has been promising an increase in procurement spending in the next year, but each time that year has arrived, the Administration has proven unable to deliver on the promise. This reveals a fundamental flaw in this Administration's handling of the defense budget which, if left unattended, will continue to plague the DOD budget. This systemic problem is explained below under "Conclusions."

- ▶ **The request for research and development (R&D) marginally decreases from \$36.6 billion to \$35.9 billion.** The President's long-term budget projects moderate decreases out to the year 2002.
- ▶ **The 1998 request for Operations and Maintenance, \$93.7 billion, is \$800 million more than last year's \$92.9 billion.** According to recent CBO analysis, the per capita cost of readiness per active duty member of the Armed Forces is continuing to grow at a historic rate that is significantly higher than that provided in the President's budget, especially in the years beyond 1998. It is, therefore, realistic to expect the Administration's recommended O&M budget to result in reduced readiness and in weakened support for what the Administration states to be its emphasis on "quality of life" for Armed Forces personnel.
- ▶ The Military Personnel account is at \$69.5 billion, a \$400 million reduction from 1997. The 1998 - 2002 budget projects moderate, nominal increases up to \$75.3 billion in 2002. According to a recent GAO study, the per capita cost of military personnel is also increasing, and if the Administration expects to save funds in this account, significant reductions in personnel and/or benefits would be required. The budget also assumes a 2.8 percent pay raise for 1998, and 3 percent pay raises for each year after 1998.
- ▶ **Military Construction and Family Housing show a reduction from \$10.0 billion in 1997 to \$8.4 billion.** These figures are a 16 percent decrease.

Department of Energy

- ▶ The budget proposes \$13.6 billion in discretionary budget authority for DOE's Atomic Energy Defense Activities (AEDA) in 1998 (budget subfunction 053). **DOE-AEDA budget authority would increase \$2.3 billion over last year's enacted level of \$11.3 billion; however, outlays would actually decrease from \$11.9 billion to 10.9 billion.** Of the increase in budget authority, \$2.2 billion would go to a new defense asset acquisition program.
- ▶ The budget request includes **\$3.5 billion for DOE weapons activities, a budget authority decrease of \$300 million.**
- ▶ The budget request includes **\$5.1 billion for Defense Environmental Restoration and Waste Management, a decrease of \$500 million from last year's \$5.6 billion.**

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Conclusion

- ▶ The Administration asserts that it will find funds to increase the procurement budget from its current \$42.6 billion request level to over \$60 billion in 2001 by exacting savings in “infrastructure” in the Operations & Maintenance (O&M) and Military Personnel accounts.² At the request of the Senate Budget Committee, CBO and GAO analyzed the extent to which the Defense Department had realistically budgeted funds to support these procurement plans while also maintaining readiness and the existing force structure. **Both agencies independently found that the current (1997) DOD Future Years Defense Program (FYDP) is “underfunded” by as much as \$50 billion in its first four to five years.**
- ▶ Taken together, these CBO and GAO analyses of the 1997 Future Years Defense Program found that -
 - Department of Energy defense activities are underfunded by at least \$3.5 billion;
 - known -- but unbudgeted -- DOD weapons cost growth for the next four years will be at least \$3 billion; it is likely to be substantially more in the later years of the Future Years Defense Program and beyond 2002;
 - DOD and CBO differ in their future inflation estimates by \$6 billion;
 - planned -- but unfunded -- submarine purchases will cost an additional \$3 billion;
 - the difference between what DOD expects to spend on O&M between now and 2001 and what historical trends show will be needed for existing forces is \$40 billion;
 - DOD has done little to reverse demographic and other trends in Military Personnel that require increasing funds just to maintain the current level of active duty enlisted men and women and officers;
 - DOD continues to engage in excessively optimistic estimates of savings from procurement and other reforms, its weapons costs estimates continue to be proven unrealistically low by unfolding events, and net savings from base closures continue to fall short of promised levels.

²“Infrastructure” can be defined to include significant portions of DOD’s logistics, civilian -- and some military -- personnel, training activities, medical programs, and installations.

- ▶ These problems are not new to the defense budget, but the mismatch between available funds and planned programs is very likely to worsen as real declines in core defense spending accounts continue to occur. There will be an opportunity to address these problems this year as DOD's **Quadrennial Defense Review (QDR)** re-considers the national security strategy, force structure, and acquisition plan set forth in the 1993 Bottom-Up-Review. However, **it is not clear whether this panel, which is due to report its recommendations on May 15, will bring the US defense program and budget into alignment or whether it will simply adopt another unrealistic mismatch of funds and programs, similar to that embraced by the Bottom-Up-Review.**

- ▶ On balance, President Clinton's National Defense (050) budget request for 1998 and the subsequent years adopts significant increases over the budgets submitted in past years. To address shortages it found in these earlier budgets, in 1996 Congress added \$6.3 billion; in 1997, it added \$10.4 billion. **The increases the President has now planned for his own defense budget are sure to elicit a favorable response from many in Congress. However, there remain significant substantive issues to be addressed. Primary among these will be a potential mismatch between budget authority and outlays that could adversely impact the "quality of life" of service men and women and an even larger potential mismatch between total funds budgeted and planned acquisition programs and force structure.**

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FUNCTION 150: INTERNATIONAL AFFAIRS

This function includes operation of the foreign affairs establishment including embassies and other diplomatic missions abroad; foreign aid loan and technical assistance activities in the less developed countries; security assistance to foreign governments; foreign military sales made through the Foreign Military Sales Trust Fund; U.S. contributions to international financial institutions; Export-Import Bank and other trade promotion activities; and refugee assistance.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
Clinton Budget:							
Budget authority	16.4	17.4	21.8	18.1	17.4	17.6	17.9
Outlays	13.5	14.8	14.9	15.9	15.2	15.3	15.5
Change from 1997:							
Budget authority	---	---	+4.4	+0.7	---	+0.2	+0.5
Outlays	---	---	+0.1	+1.1	+0.4	+0.5	+0.7

The 1998 budget increases total budget authority for international affairs by \$4.4 billion, or 25 percent and increases discretionary budget authority by \$4.9 billion or 27 percent.

- ▶ The Clinton budget proposes \$1.0 billion in budget authority for the **International Development Association (IDA)**, calling for a 48 percent increase from \$700 million in 1997.
- ▶ The President's budget proposes to increase the **Contributions to International Organizations (CIO)** to \$1.0 billion, a 15 percent increase from the 1997 enacted level of \$892 million. Included in this amount is a \$320 million contribution to the United Nations.
- ▶ The 1998 budget request proposes to decrease the **Contributions to International Peacekeeping Activities** to \$286 million, a 66 percent decrease from the 1997 enacted level of \$352 million. The President includes a 1997 supplemental appropriation request for a 1999 advance appropriation of \$921 million for UN arrears.
- ▶ The 1998 budget request proposes an increase in the US subscription for the **International Monetary Fund's** emergency borrowing facility. Instead of expanding the original General Arrangements to Borrow (GAB), the IMF has chosen to create the New Arrangements to Borrow (NAB) thereby allowing countries other than the G-10 to

participate and reflects the IMF and Treasury Department's decision to increase the size by 4.25 billion SDR (\$3.5 billion), scored as budget authority only. This is a transfer of monetary assets and therefore results in no associated outlays.

- ▶ The 1998 budget request proposes funding the **Assistance to the Former States of the Soviet Union** at \$900 million, a 56 percent increase from the 1997 enacted level of \$578 million. Sixty-six percent of the requested funds are requested for the President's new Partnership for Freedom initiative, a series of new or expanded programs aimed at encouraging economic growth and democracy.
- ▶ The 1998 budget request proposes an increase in **Consular and Passport Fees** of \$595 million in 1998 to offset a corresponding decrease in the Diplomatic and Consular Affairs request.
- ▶ The 1998 budget request proposes funding for the new **Bank for Economic Cooperation and Development in the Middle East and North Africa** at \$53 million in 1998 with funds transferred from the Economic Support Fund.
- ▶ The Administration's budget would move the **P.L. 480 Title I program**, at a requested level of \$188 million, from this budget function to Agriculture, budget function 350. The program provides the subsidy amounts associated with the financing of sales of agriculture commodities to developing countries. This program is under the jurisdiction of the Agriculture and Rural Development Appropriations Subcommittee

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FUNCTION 250: SPACE, SCIENCE AND TECHNOLOGY

This function includes the National Aeronautics and Space Administration (NASA) civilian space program, and basic research programs of the National Science Foundation (NSF) and Department of Energy (DOE).

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	16.7	16.7	16.5	16.5	16.3	16.3	16.3
Outlays	16.7	16.6	16.5	16.4	16.2	16.1	16.1
Change from 1997:							
Budget authority	---	---	-0.2	-0.2	-0.4	-0.4	0.4
Outlays	---	---	-0.1	-0.2	-0.4	-0.5	-0.5

The 1998 budget continues to reflect the President's redirection of government from space, defense and basic scientific research to civilian technology and development.

- ▶ The President's budget is proposing to continue streamlining at the **National Aeronautics and Space Administration (NASA)**, requesting 1998 funding for NASA at a level of \$13.5 billion, a \$200 million decrease from 1997.
- ▶ The budget request will reduce NASA to \$13.2 billion in 2000 through 2002.
- ▶ The President is requesting \$2.1 billion in BA for the **international space station**, the same as 1997. **Space shuttle flight and operations** has been reduced by \$200 million to \$3.0 billion. Most of this is a \$150 million reduction to safety and performance upgrades for the space shuttle.
- ▶ **NASA aeronautical research and technology activities** in function 400 are funded at \$1.37 billion, an increase of \$100 million over 1997.
- ▶ The President's budget proposes to fund the **National Science Foundation (NSF)** at \$3.4 billion, an increase of \$100 million from the 1997 level. The President's budget maintains this level of funding for NSF through 2002.

- ▶ Measured from 1997, the President would increase **NSF research and related activities** to \$2.3 billion, an increase of \$100 million from last year and maintain **major research equipment** at its 1997 level of \$100 million.
- ▶ The budget funds **Department of Energy (DOE) general science programs** at \$876 million, a decrease of \$120 million from 1997.

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FUNCTION 270: ENERGY

This function includes the civilian activities of the Department of Energy, the Rural Electrification Administration, the power programs of the Tennessee Valley Authority (TVA) and the Nuclear Regulatory Commission (NRC).

	(\$ Billions)						
	1996 Actuals	1997	1998	1999	2000	2001	2002
Clinton Budget:							
Budget authority	2.6	1.0	1.9	1.2	2.1	1.3	-0.1
Outlays	2.8	2.1	2.3	1.3	2.0	1.6	-0.4
Change from 1997:							
Budget authority	---	---	0.9	0.2	1.1	0.3	-1.1
Outlays	---	---	0.2	-0.8	-0.1	-0.5	-2.5

The President's budget proposal for this function projects funding of between \$1.0 and \$3.2 billion from 1997 through 2007 with the significant exception of the year 2002 which projects spending of \$-400 million. The President's budget proposes savings in this function by conducting a sale of oil from the strategic petroleum reserve in order to generate a one-time receipt of \$1.1 billion in 2002. The President's budget also assumes a one-time receipt of \$1.0 billion in 2002 from the sale of government-owned uranium. The President's budget makes funding for Department of Energy (DOE) programs to commercialize technologies a priority. While commercialization efforts enjoy increases, programs that fund basic science are reduced, frozen or receive nominal increases.

- ▶ The President's budget proposes an oil sale from the **strategic petroleum reserve (SPRO)** in 2002 in order to generate a one-time receipt of \$1.1 billion. Congress created the SPRO facility in 1975 to provide a stockpile of oil in the event of oil supply disruptions. Although referred to as the sale of "Weeks Island" oil, the DOE is decommissioning the "Weeks Island" facility due to structural problems. The transfer of the "Weeks Island" inventory stock of crude oil to other SPRO facilities was completed in January 1997. Instead of proposing the oil sale in 1998 (or in 1997 prior to incurring the cost of transferring the oil out of the "Weeks Island" facility) the Administration proposes a one-time sale of SPRO crude oil in order to generate a one-time receipt of \$1.1 billion in 2002.

- ▶ The President proposes the largest increases in this function for programs to commercialize energy technologies. The President proposes to increase **energy conservation** funding, which subsidizes efforts to commercialize technologies and funds low-income weatherization grants, by \$138 million in 1998, a 25 percent increase over the previous year's level. The President also proposes to increase funding for the commercialization of **solar and renewable** technologies, proposing an increase of \$72.6 million, a 27 percent increase.
- ▶ While asking for major increases for commercializing technologies, the Administration does not place a priority on **DOE's basic scientific activities**, proposing reductions in biological and environmental research (-3 percent), fusion energy research (-3 percent) and a freeze on basic energy sciences.
- ▶ The President would increase spending for DOE **Departmental Administration** by \$11 million in FY 1998, a 12 percent increase over the previous year's level. Departmental Administration funds functions such as the Office of the Secretary, human resources and administration, and the policy office. The President's budget proposes to reduce funding for **fossil energy research** (oil, gas, and coal) by \$19 million, a 5 percent decrease.

FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT

This function includes a wide variety of programs whose primary purpose is to develop, manage, and maintain the nation's natural resources and environment. Agencies with major programs in this function include: the Army of Corp of Engineers, Bureau of Reclamation, Forest Service, Bureau of Land Management, Fish and Wildlife Service, the National Park Service, Environmental Protection Agency, National Oceanic and Atmospheric Administration, and the U.S. Geological Survey.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	21.6	22.1	23.7	23.4	22.9	22.8	22.8
Outlays	21.6	22.8	22.3	22.6	23.1	23.2	23.0
Change from 1997:							
Budget authority	---	---	+1.6	+1.3	+0.8	+0.7	+0.7
Outlays	---	---	-0.5	-0.2	+0.3	+0.4	+0.2

- ▶ The President proposes new user fees totaling \$44 million for 1998 and \$796 million over the five year period. They include:
 - **Increase wetlands dredging permit fees** (Corp of Engineers) - \$63 million.
 - **Extend and index hardrock mining holding fees on public lands** (Bureau of Land Management) - \$135 million.
 - **Establish hardrock mining royalties on public lands (5 percent net smelter return)** (Bureau of Land Management) - \$175 million.
 - **Increase Hetch Hetchy Dam rental payments** (National Park Service) - \$5 million.
 - **Extend demonstration authority to collect recreation fees and related fees** (National Park Service, Fish and Wildlife Service, Bureau of Land Management, and Forest Service) - \$243 million.

- **Establish Everglades sugar assessment** (National Park Service) - \$175 million.
- ▶ The Administration proposes an increase of \$0.1 billion, to \$1.9 billion, for the **EPA's environmental programs and management**, which includes funds for salaries, travel, contracts, grants, and cooperative agreements for pollution abatement, control, and compliance activities.
- ▶ The President's budget proposes \$2.3 billion for the **superfund program**, an increase of \$0.9 billion over 1997. This includes \$200 million in BA from the legislative proposal described below.
- ▶ The Administration also proposes reforms which allow costs allocated to identifiable, but nonviable parties at sites, and certain other categories of costs to be paid from the Hazardous Substance Superfund as mandatory spending (**superfund orphan shares**). This proposal costs \$880 million in outlays over 5 years.
- ▶ The Administration requests \$3.1 billion for the **Forest Service**, a decrease of \$0.3 billion under 1997. The difference is largely due to emergency funding that was made available in 1997 for fire fighting.
- ▶ The \$1.6 billion budget proposed for the **National Park Service** includes a \$65.7 million increase in basic operating funds.

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FUNCTION 350: AGRICULTURE

This function includes programs that intend to promote the economic stability of agriculture. Programs in this function include direct assistance and loans to food and fiber producers, market information and agricultural research. Producers are assisted with production flexibility contract payments, crop insurance, non-recourse crop loans, operating loans and export promotion.

The price support programs operated by the Commodity Credit Corporation (CCC) make up most of the spending in this function. Agriculture spending has varied widely over the last 25 years. CCC spending has gone from \$0.6 billion in 1975 to a record high of \$26 billion in 1986.

	(\$ Billions)						
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	9.6	11.4	12.1	11.8	11.3	10.3	10.1
Outlays	9.2	10.3	12.3	11.8	11.2	10.0	9.8
Change from 1997:							
Budget authority	---	---	+0.7	+0.4	-0.1	-1.1	-1.3
Outlays	---	---	+2.0	+1.5	+0.9	-0.3	-0.5

Farm policy is driven by the Federal Agricultural Improvement and Reform (FAIR) Act of 1996 which became law on April 4, 1996. The FAIR Act was designed to give the farmers flexibility in planting decisions based on market conditions and not government programs. The Act terminated production control programs of the depression era and provided a market transition into the 21st century. The FAIR Act also included a spending cap on the major program crops which will limit unforeseen spending increases which have frequently occurred in past years.

The Administration projects **Commodity Credit Corporation** (CCC) outlays to total \$7.8 billion in 1997 and \$9.9 billion in 1998. CCC outlays total \$43.7 billion over five years. According to the Department of Agriculture, the increase in outlays from 1997 to 1998 is due to an increase in income support payments, lending activities and increased spending for conservation and export programs.

- ▶ The FAIR Act authorized funding for the **Conservation Reserve Program** (CRP) from the CCC and also authorized several changes. The Administration projects an enrollment of 36.4 million acres by 2002 (the maximum provided by law). The Administration

projects spending of \$1.9 billion in 1998, an increase of \$154 million above 1997. The Administration projects \$9.8 billion in outlays over five years.

- The Administration proposes savings of \$25 million in 1998 and \$125 million over 5 years by permitting haying and grazing on CRP acreage once every 3 years in exchange for a 50 percent reduction in the contract rental payment.
- ▶ The Administration proposes to expand the **revenue insurance program** from its current pilot status to a nationwide program. The expansion would increase the crop insurance fund by \$26 million and would increase administrative and operating expenses. The Department proposes to offset the additional cost by making several changes, including reducing the loss ratio target and the administrative reimbursement rate paid to private companies. This proposal saves \$21 million in 1998 and \$25 million over the five year period. Although the President's budget shows savings for this proposal, it does have the potential to increase taxpayer's liability.
- ▶ The Administration proposes \$36 million in new **user fees** in 1998 and \$196 million over the five year period for the Grain Inspection, Packers and Stockyard Administration (GIPSA), Animal Plant Health Inspection Service (APHIS) and the Agriculture Marketing Service (AMS). They include:
 - \$92 million for GIPSA licensing fees;
 - \$50 million for APHIS testing, inspection and eradication services;
 - \$196 million to cover AMS costs of administering marketing agreements and orders.
- ▶ The budget provides the authorized level of \$90 million per year for the **market promotion program**.
- ▶ The President proposes \$500 million for the **export enhancement program**, an increase of \$400 million above 1997. The budget includes \$2.6 billion over the 5 year period.
- ▶ The budget provides \$786 million for the **Agriculture Research Service (ARS)**. This is the same amount provided in 1997. The Administration proposes to increase ARS **research programs** by \$10 million and also to reduce **buildings and facilities** by \$10 million.
- ▶ The Administration proposes \$842 million for the **Cooperative State Research, Education, and Extension Service (CSREES)**, a decrease of \$70 million below the 1997 level. Within CSREES, the President proposes to terminate **buildings and facilities** and **special research grants**. These terminations save \$102 million in 1998.

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- ▶ The **National Agriculture Statistics Service's** budget includes an increase of \$18.5 million for a total of \$120 million in 1998. The additional increase is for the Census of Agriculture which has previously been conducted by the Bureau of Census.

FUNCTION 370: COMMERCE AND HOUSING CREDIT

This function includes discretionary housing programs, such as subsidies for single and multifamily housing in rural areas and mortgage insurance provided by the Federal Housing Administration; net spending by the Postal Service; discretionary funding for commerce programs, such as international trade and exports, science and technology, the census, and small business; and mandatory spending for deposit insurance activities related to banks, savings and loans, and credit unions.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	8.3	12.8	8.3	10.7	16.7	16.6	18.0
Outlays	-10.6	-8.8	3.4	6.3	12.6	7.3	8.1
Change from 1997:							
Budget authority	---	---	-4.5	-2.1	+3.9	+3.8	+5.2
Outlays	---	---	+12.2	+15.1	+21.4	+16.1	+16.9

While the President's 1998 budget appears to propose a \$4.5 billion decrease in budget authority from the 1997 level for all activities in this function, the fact that outlays would increase by \$12.2 billion suggest a more complicated story. Basically, the unique nature of the mandatory programs in this function, such as the Postal Service and deposit insurance, obscures the President's proposals in most other areas. Looking at discretionary programs alone, the President proposes to increase budget authority from \$2.4 billion in 1997 to \$3.3 billion in 1998, a 40 percent jump.

Discretionary Spending

- ▶ The largest increase is for the **Bureau of the Census**, which would receive \$661 million (a 91 percent hike over the 1997 level) to gear up for the census in 2000.
- ▶ Other increases are provided for the **National Institute of Standards and Technology (NIST)**, which would receive \$399 million, or 25 percent, more than the 1997 funding level for **Industrial Technology Services**. Of this amount, a \$50 million (22 percent) increase would go to the **Advanced Technology Program**, which grew from \$86 million in 1993 to \$523 million in 1995, but then slowed to \$335 million in 1996 and \$225 million in 1996. The **Manufacturing Extension Partnership** would receive the balance of the increase, growing 30 percent to a 1998 level of \$124 million.

Mandatory Spending

For this category of spending, the story remains complicated in this function. Budget authority would decrease from \$10.5 billion in 1997 to \$5.0 billion in 1998, while outlays would increase instead from -\$11.4 billion in 1997 to about zero dollars in 1998.

Many of these swings are driven by baseline changes in certain programs. The **Postal Service**, for instance, runs cyclical surpluses and deficits, depending on when the price of stamps increases. In 1998, the Postal Service deficit will increase by \$2.1 billion, but budget authority requirements will decrease. In addition, outlays of the **Savings Association Insurance Fund (SAIF)** will increase from 1997 to 1998 by \$4.1 billion, because SAIF received a one-time recapitalization payment from savings and loans in 1997 resulting from the “fix” included in the Omnibus Appropriations Act for 1997. For SAIF, however, there is no corresponding change in budget authority, just as there is little change in budget authority for other deposit insurance activities. But outlays for these other activities (Bank Insurance Fund, FSLIC Resolution Fund) are expected to increase by \$3.9 billion from 1997 to 1998.

Significant changes to mandatory programs resulting from Administration proposals are as follows:

- ▶ For the single-family mortgage insurance program operated by the **Federal Housing Administration (FHA)**, the President proposes a dramatic increase in the size of mortgage that the FHA will be allowed to insure. Currently, FHA can insure mortgages up to about \$155,000. But under the proposal, the FHA could insure mortgages as large as \$215,000, allowing the FHA to compete for business that the private sector now services. Because the fees that FHA charges for issuing these insurance policies generate net income (the program is a negative subsidy program under credit reform), this proposal to expand the line of business would generate \$0.2 billion in additional receipts annually.
- ▶ Also in FHA, the President proposes to extend existing practice as it applies to how FHA handles claims on defaulted mortgages for new insurance policies issued in 1998 and beyond. This proposal would save \$0.9 billion over the 1998-2002 period.
- ▶ The President again proposes to have the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve **charge state banks a fee** to cover the costs of their safety and soundness examinations. While the FDIC fee would have no cumulative net impact in this function because of offsetting reductions in deposit insurance premiums in the Bank Insurance Fund, the Federal Reserve fees would appear as \$0.4 billion in new revenues (over the next five years) in the form of the Fed’s annual payment to the Treasury.

FUNCTION 400: TRANSPORTATION

This function supports all major modes of transportation. Function 400 includes ground transportation programs, such as the federal-aid highway program; mass transit operating and capital assistance; rail transportation through the National Rail Passenger Corporation (Amtrak), high-speed rail and rail safety programs; air transportation through the Federal Aviation Administration (FAA) airport improvement program, facilities and equipment program, and operation of the air traffic control system; water transportation through the Coast Guard and Maritime Administration; and related transportation support activities.

	(\$ Billions)						
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	36.6	43.8	44.2	42.9	43.0	43.3	43.0
Outlays	39.6	39.3	39.3	39.4	39.3	39.4	39.2
Change from 1997:							
Budget authority	---	--	0.4	-0.9	-0.8	-0.5	-0.8
Outlays	---	--	0.0	0.1	0.0	0.1	-0.1

The President's budget reduces federal capital transportation spending while creating new user fees for operating and support activities for transportation. The budget proposes total budget authority for transportation of \$44.2 billion, an increase of \$400 million from 1997. However, total outlays, obligation limitations and mandatory highway obligations for transportation total \$39.3 billion, the same amount as 1997. Outlays accompanying this proposal remain frozen through 2002.

- ▶ The President's budget proposes a short-term extension of the **aviation excise taxes** which expired on December 31, 1996. The date of enactment is April 1, 1997, with the taxes set to expire again on October 1, 1998.

After October 1, 1998, these taxes will be collected as **aviation cost-based user fees**. These fees would be classified as revenues, raising \$27.2 billion between 1999 and 2002. Under this proposal, the discretionary spending caps would be raised by \$23.0 billion, the net receipts from the new user fees. Under a cost-based user fee, the President's budget request does not significantly raise spending on aviation between 1997 and 2002. The President's budget request for the FAA is \$8.5 billion for 1998, rising to \$9.4 billion in 2002. This aggregate increase in

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FAA funding of \$1.7 billion is far below the \$23 billion increase in the discretionary spending caps due to the net receipts from the proposed aviation user fees.

- ▶ The President requests \$8.5 billion in budget authority for programs of the **Federal Aviation Administration (FAA)**. The request includes \$5.4 billion for **operations**, an increase of \$400 million over 1997; \$1.9 billion for **facilities and equipment**, the same level as 1997; and \$200 million for **research, engineering and development**, also the same as provided in 1997.
- ▶ The Clinton budget requests an obligation limitation of \$1.0 billion for the **Airport Improvement Program (AIP)**, a decrease of nearly \$500 million from the 1997 level.
- ▶ The President's budget has requested \$350 million in **aviation user fees** for 1998. These fees are designed to offset FAA operations and provide most of the increase in this account for 1998. These fees are different from the cost-based user fees which replace the aviation excise taxes beginning in 1999.
- ▶ The Administration has requested total five-year contract authority of \$138 billion for highways, mass transit, and highway safety programs for the reauthorization of the **Intermodal Surface Transportation Efficiency Act (ISTEA)**. This amount represents a reduction of \$8.5 billion from the current law spending path for contract authority. The President has requested a total **Federal Highway Administration federal-aid highway obligation limitation** of \$18.2 billion, the same as 1997. **Federal Highway Administration** funding is set at \$20.1 billion, an increase of \$400 million from 1997.
- ▶ The 1998 budget request for the **Federal Transit Administration (FTA)** freezes 1997 spending at \$4.38 billion. The budget proposes combining **Transit Section 9 formula grants, operating assistance, and Section 3 Rail Modernization and Bus and Bus Facilities** into one formula program. **Transit Section 3 discretionary grants** have been decreased to \$634 million from their 1997 level of \$760 million.
- ▶ The President's request provides \$767 million for the **National Passenger Rail Corporation (AMTRAK)**, a reduction of nearly \$100 million from 1997. The President's request for Amtrak includes \$344 million for **operations and mandatory rail payments to rail workers**, and \$423 million for **capital equipment**. Funding of up to \$200 million would be provided for the **Northeast Corridor Improvement Program** from the capital account. The President has also proposed that for the first time all Amtrak funding would come directly from the **Highway Trust Fund**.
- ▶ The Clinton budget proposes \$20 million for the **Next Generation High-Speed Rail program**, a decrease of \$5 million from 1997.

- ▶ For the **U.S. Coast Guard**, the budget proposes \$3.9 billion, an increase of nearly \$100 million above the 1997 enacted level. The President proposes \$2.7 billion for Coast Guard **operating expenses**, and \$370 million for **acquisition, construction and improvements**.
- ▶ The budget provides \$163 million for the **Maritime Administration** (MARAD), essentially the same level as 1997.
- ▶ The President proposes that **Essential Air Service** be funded at \$50 million, consistent with the 1996 FAA Reauthorization Act which established offsetting collections dedicated to Essential Air Service.
- ▶ The budget request provides offsetting collections totaling \$14.3 million for salaries and expenses for the **Surface Transportation Board**.
- ▶ The President's request provides \$1.37 billion for **aeronautical research and technology** activities provided for NASA within function 400.

Mandatory Spending

- ▶ The President has proposed increasing the **Minimum Allocation program** by \$106 million between 1998 and 2000, while making reductions totaling \$104 million in 2001 and 2002.
- ▶ The budget assumes extension of **vessel tonnage fees**, set to expire at the end of 1998. This proposal raises \$62 million per year, \$248 million between 1999 and 2002.
- ▶ The President generates \$209 million in discretionary savings by reclassifying two discretionary transportation programs as new mandatory spending. The President's request would make the current discretionary **Coast Guard boat safety state grant program** a new mandatory program. This recommendation would increase mandatory spending by \$147 million over the next five years. The President's request would make the current discretionary **St. Laurence Seaway Development Corporation** a new mandatory program. The proposal would make the seaway a performance-based organization (PBO) and would increase mandatory spending by \$62 million over the next five years.

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- ▶ The President's proposal would provide for the sale of **Governor's Island** and **Union Station air rights**. These asset sales are projected to raise \$500 million and \$40 million, respectively, but are delayed until 2002 to generate a one-time receipt of \$540 million.

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

This function covers the regional and developmental programs that fund the development of physical facilities or financial infrastructures to assist viable community economies. The major programs are administered through a variety of agencies including the Department of Housing and Urban Development, Appalachian regional Commission (ARC), Tennessee Valley Authority, Economic Development Administration (EDA), Bureau of Indian Affairs, Federal Emergency Management Agency, and the Department of Agriculture.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	12.5	10.4	11.3	8.8	8.0	8.1	8.0
Outlays	10.7	12.8	11.4	11.4	9.6	8.4	8.0
Change from 1997:							
Budget authority	---	---	+0.9	-1.6	-2.4	-2.3	-2.4
Outlays	---	---	-1.4	-1.4	-3.2	-4.4	-4.8

Most of the spending for this function is for discretionary programs. While spending decreases over the 5-year period when compared to 1997 the President proposes a one time increase in 1998.

- ▶ The budget proposes to establish a **contingency emergency reserve account** to fund unanticipated needs arising from both natural disasters and man-made disasters. The Administration request \$5.8 billion over five years which is based on the average emergency budget authority adjustment made to the discretionary spending caps established under the Budget Enforcement Act of 1990. The fund will be used by the Department of Agriculture, Interior, Transportation, the Federal Emergency Management Agency, the Small Business Administration, and the Army Corps of Engineers. Funds will be made available to cover costs that exceed budget assumptions for emergency requirements. The spending authority from this account is not displayed in this function or in the President's budget totals.
- ▶ The President's budget requests \$4.6 billion for **community development block grants**, the same level as provided in 1997.
- ▶ The Administration includes \$847 million for the **operation of Indian programs** through the Bureau of Indian Affairs. This is an increase of \$79 million from the 1997 level.

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- ▶ The budget proposes to create the empowerment zone and **enterprise communities program**. The President proposes \$100 million in 1998 to fund the new program. The program would provide grants to support the financing of capital projects, including housing and economic development in urban empowerment zones and enterprise communities.
- ▶ The President proposes \$25 million in 1998 for the **Brownfields redevelopment program**. This is the first of four annual funding requests for a total of \$100 million.
- ▶ The President's budget would authorize funding for the **Fund for Rural America** in 1998. The budget would shift the \$100 million available in 2000 to 1998. This proposal increases spending by \$10 million over the five year period.
- ▶ The Administration proposes a **radiological emergency preparedness fee** which would increase receipts by \$12 million per year, or \$60 million over the 5-year period.

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

This function includes those activities designed to promote the acquiring of knowledge and skills, to provide social services for needy individuals, and for research directly related to these program areas. In general, the activities funded by this function are administered through the Departments of Labor, Health and Human Services, and Education.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	52.0	53.9	64.7	62.4	64.0	64.3	64.9
Outlays	52.0	51.3	56.2	61.7	63.2	63.9	62.8
Change from 1997:							
Budget authority	--	--	10.8	8.5	10.1	10.4	11.0
Outlays	--	--	4.9	10.4	11.9	12.6	11.5

- ▶ For **Function 500**, the President is requesting \$64.7 billion for 1998, with funding relatively constant through 2002, when the funding is projected to be \$64.8 billion.

Department of Education Programs

- ▶ In total for education, the President is requesting \$39.5 billion, \$29.1 billion for discretionary programs, an 11 percent increase over 1997 levels. The balance of the request is \$10.4 billion for mandatory programs, a 229 percent increase over 1997!
- ▶ Within the **Department of Education**, the President is proposing **at least five new programs** and reintroducing proposals from previous budgets. The centerpiece of the President's education agenda is a new **higher education tax credit** of up to \$1,500 for first and second-year college students who maintain a 'B' average, and a new **higher education tuition tax deduction** worth \$5,000 and \$10,000 for the years 1999 and beyond. Families will have to choose between the two options, both the deduction and the credit phase out completely for joint filers with incomes of \$100,000, and eligibility for the credit is offset by any other grant aid the student receives (see revenue section).

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- ▶ New proposals in Elementary and Secondary Education include a new mandatory program, the **America Reads Challenge**, funded at \$1.2 billion over five years, and a new mandatory, 3 year, \$5 billion **School Construction Initiative**.
- ▶ The President renews his proposal to fund the **Presidential Honors Scholarships** program providing a 1-year \$1,000 scholarship to each high school student graduating in the top 5 percent of his or her class. This program will be funded at \$132 million.
- ▶ The President is proposing an **expanded IRA** for higher educational expenses whereby families could withdraw funds penalty-free (see revenue section). Additionally, under the President's plan, the **tax code would be modified to allow a student direct loan borrower participating in the Department's income-contingent repayment, to exclude from income any unpaid loan balance left on the books after 25 years**. At the time income-contingent loans were instituted in 1994, the Department estimated that 12 percent of students would ultimately not repay their loans in 25 years.
- ▶ The President proposes \$7.6 billion for **Pell Grants**, a \$1.7 billion increase over the 1997 level, which includes \$171 million in surplus funding. The President proposes a maximum grant size of \$3,000. The current maximum award is \$2,700.
- ▶ The President assumes a significant restructuring of the **FFEL or guaranteed student loan program**, including \$3.1 billion in program reductions over the next five years.
- ▶ The Administration's budget would recall \$730 million from **guarantee agency reserves** and \$2.5 billion over the next five years. The Administration proposes that guarantee agencies no longer hold federal funds in reserve to pay default claims and direct federal payments will be used to pay these claims. Additionally, the President proposes reducing the **guarantee agency retention allowance**, which guarantee agencies receive as a result of collecting on defaulted loans, from 27 to 18.5 percent.
- ▶ The President's budget would increase **lender default risk sharing** from 2 to 5 percent. Lenders would be reimbursed for 95 percent of eligible default claims instead of the current 98 percent. Additionally, under current law, lenders may pay student loan origination fees for students, at their discretion. The President would require that if lenders pay the origination fee for some students, they must pay it for all.
- ▶ The Budget proposes the elimination of the **State Student Incentive Grant** program for a five-year savings of \$50 million.
- ▶ The President's budget continues the policy of allowing schools to choose between the **Direct Student Loan and FFEL Program**. The Administration's baseline assumes that

36 percent of all schools will participate in the **Direct Student Loan** program in school year 1996-97 and participation will grow to 50 percent in the 1999-2000 school year.

- ▶ The Administration continues to propose the continuation of different accounting rules for certain administrative costs under the **direct and guaranteed student loan programs**, until “a sound methodology can be developed.” While the budget resolution, for the past two years, has had an accurate accounting methodology to level the playing field between the two programs, the Administration has not yet adopted or proposed an alternative methodology.
- ▶ The President’s budget is proposing \$7.5 billion for **Title I, Education for the Disadvantaged**, a \$347 million increase over the 1997 level.
- ▶ For the Education Reform account, the President proposes \$620 million for **Goals 2000**, a \$129 million increase over 1997, and \$200 million for **School to Work**, a \$27 million increase over 1997. Within this account, the President also proposes \$425 million for the **Technology Literacy Challenge Fund**, a \$225 million increase.
- ▶ The President’s budget proposes \$658 million for the **Impact Aid** program, which is \$72 million below the 1997 level.
- ▶ For **School Improvement Programs**, the President proposes \$1.3 billion, a \$127 million reduction from the 1997 level. The biggest cut is a 42 percent reduction in the Eisenhower Professional Development program.
- ▶ The President proposes \$4.2 billion for **Individuals with Disabilities Education Act (IDEA)**, an increase of \$174 million above 1997, as well as consolidation of **IDEA Special Purpose Funds**.

Other Programs

- ▶ For the **Department of Labor**, the President’s budget proposes total funding of \$37.9 billion, a \$3.5 billion increase over the 1997 level, \$2.4 billion of which is new mandatory spending.
- ▶ The President proposes a new, mandatory, **Welfare-to-Work Jobs** initiative to complement the recently enacted welfare reform legislation (see discussion in Function 600). It would provide \$3 billion over the next three years for job placement and job creation. States would use funds to provide subsidies and incentives to private businesses who hire people off of welfare. The President is also requesting additional staff at the Department of Labor -- 75 FTE -- to administer this new program.

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- ▶ The Administration proposes to transfer the **Community Service Employment for Older Americans** program, which was funded at \$463 million in 1997, to the Administration on Aging. The Administration would provide an additional \$448 million to the Administration on Aging to accommodate this program and assumes level funding for the entire agency through 2002.
- ▶ For the **Administration on Children and Families**, the President is requesting \$16.8 billion, a \$3.1 billion increase over the 1997 level.
- ▶ For **Head Start** the President is requesting \$4.3 billion, an increase of \$324 million over the 1997 level.
- ▶ The Administration proposes \$2.4 billion for the **Social Services Block Grant**, a \$120 million decrease from the 1997 level. The president would level fund this program through 2002.
- ▶ For **National and Community Service Programs**, the President's budget proposes \$547 million, a \$147 million increase over the 1997 level.

FUNCTION 550: HEALTH

This function covers all health spending except that for Medicare, military health, and veterans health. The major programs include Medicaid, health benefits for federal retirees, the Food and Drug Administration, the Health Resources and Services Administration, the Indian Health Service, the Centers for Disease Control and Prevention, the National Institutes of Health, and the Substance Abuse and Mental Health Services Administration.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	109.9	130.1	133.8	145.1	152.1	159.8	165.4
Outlays	119.4	127.6	138.2	145.1	152.0	159.6	165.3
Change from 1997:							
Budget authority	---	---	+3.7	+15.0	+22.0	+29.7	+35.3
Outlays	---	---	+10.6	+17.5	+24.4	+32.0	+37.7

Medicaid

- ▶ The President's budget proposes reforms to Medicaid that would save \$22.4 billion over the five year period 1998-2002. It then spends \$13.2 billion over that same period on new Medicaid benefits, for net Medicaid savings of \$9.3 billion.
- ▶ The President's budget proposes to cut and restructure payments in the Disproportionate Share Hospital (DSH) program. No specific savings estimate for the DSH policy changes is given. The DSH program accounts for about \$10.3 billion (10 percent) of 1998 medicaid spending.
- ▶ The President's budget proposes a per capita cap to limit federal spending per beneficiary. Payments to states would be restricted, but current law eligibility and benefit requirements would remain. Spending would be on a per beneficiary basis, and would be based on a base-year amount, increased by an unspecified annual growth limit.
- ▶ This per capita cap creates an enormous unfunded mandate on the States. The President's Medicaid proposal takes a significant step by repealing the Boren amendment on provider payment rates. At the same time, it would save federal dollars primarily through changes to DSH payments and by transferring costs to states through the combination of the per

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capita limit on federal spending and the maintenance of an individual's right to sue in federal court.

Medicaid Outlays (\$ Billions)							
	1996	1997	1998	1999	2000	2001	2002
President's Budget:							
Outlays	92.0	98.5	105.8	111.6	118.2	125.2	133.4
Change from 1997:							
Outlays	---	---	+7.3	+13.1	+19.7	+26.7	+34.9

Medicaid Policy Changes (Deficit Effect, \$ Billions)						
	1998	1999	2000	2001	2002	5 year total
Savings proposals	+0.2	-1.6	-4.1	-7.3	-9.7	-22.4
Kids' health in medicaid	+0.3	+0.6	+0.9	+1.4	+1.5	+4.8
Welfare revisions effect	+0.7	+0.9	+1.0	+1.3	+1.4	+5.2
Other interactions	+0.2	+0.6	+0.7	+0.8	+1.0	+3.2
Subtotal, new spending	+1.2	+2.0	+2.6	+3.4	+3.9	+13.2
Net savings	+1.4	+0.4	-1.4	-3.9	-5.8	-9.3

Other health programs

- ▶ Funding for the **Centers for Disease Control and Prevention** (CDC-P) would increase \$15 million in 1998 over the 1997 level of \$2.3 billion, a 0.7 percent increase.
- ▶ **Consumer safety** funding would decrease by \$170 million in 1998, from \$2.04 billion.
- ▶ Funding for the **National Institutes of Health** (NIH) would increase \$337 million in 1998 over the 1997 level of \$12.7 billion, a 2.6 percent increase.
- ▶ Funding for **Indian health** would increase \$68 million in 1998 over the 1997 level of \$2.06 billion, to 2.13 billion, a 3.3 percent increase.

- ▶ Funding for the **Substance Abuse and Mental Health Services Administration (SAMHSA)** would increase \$22 million in 1998 over the 1997 level of \$2.18 billion, a 1 percent increase.
- ▶ Funding for the **Food and Drug Administration (FDA)** would decrease \$68 million in 1998 from the 1997 level of \$1.0 billion, a 7.7 percent cut.
- ▶ Funding for programs in the **Health Resources and Services Administration (HRSA)** would decrease \$89 million in 1998 below the 1997 level of \$3.4 billion, a 2.6 percent decrease.
- ▶ The President's budget proposes **new entitlement spending** costing \$13.6 billion over a five year period. The budget proposes to assist individuals when they lose their jobs, by paying for private insurance coverage for "up to six months." The President's budget terminates this expensive program one year before trying to reach balance. The budget also proposes \$3.8 billion of spending to subsidize health insurance for children.

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Summary of Health Entitlement Changes
(Deficit Effect, \$ Billions)

	1998	1999	2000	2001	2002	5 year total
Savings proposals						
Medicare	-6.6	-13.8	-24.5	-30.2	-36.8	-111.9
Medicaid	+0.2	-1.6	-4.1	-7.3	-9.7	-22.4
Subtotal, savings	-6.4	-15.4	-28.6	-37.5	-46.5	-134.3
Addbacks						
Medicare	+2.3	+2.4	+2.4	+2.4	+2.3	+11.7
Medicaid	+1.2	+2.0	+2.6	+3.4	+3.9	+13.2
Health insurance subsidies	+1.7	+2.5	+2.7	+2.9	+0.0	+9.8
Kids' health insurance	+0.8	+0.8	+0.8	+0.8	+0.8	+3.8
Subtotal, new spending	+6.0	+7.6	+8.4	+9.5	+6.9	+38.4
Net savings						
Medicare	-4.3	-11.4	-22.2	-27.8	-34.6	-100.2
Medicaid	+1.4	+0.4	-1.4	-3.9	-5.8	-9.3
Health insurance subsidies	-2.5	+3.2	+3.4	+3.7	+0.8	+13.6
Total, net savings	-0.4	-7.8	-20.1	-28.0	-39.6	-95.9

FUNCTION 570: MEDICARE

This function includes only the Medicare program. Medicare pays for medical services for about 38.1 million senior and disabled citizens, and for those with End Stage Renal Disease. Medicare is administered by the Health Care Financing Administration, part of the Department of Health and Human Services.

	(\$ Billions)						
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Net Outlays	174.2	194.3	207.1	219.6	229.3	246.0	263.2
Change from 1997:							
Net Outlays	---	---	+12.8	+25.3	+35.1	+51.7	+68.9

The President's Medicare plan looks remarkably similar to prior Administration proposals. The numbers have been updated to account for an additional year of uncontrolled program growth, and there is a new proposal to save \$34 billion from payments to Medicare HMOs. Other than that, the President's Medicare reform plan is largely unchanged.

Baseline Differences

In past years there have been significant differences between the CBO and OMB Medicare baselines. In the aggregate, the baselines are now quite close. Over the next five years, the baselines differ by only \$5 billion, or less than 0.4 percent.³ There are still differences in various components of the baseline. These differences will affect scoring of specific policy options.

³ Since the baselines are so close this year, the Administration's savings estimates are taken as given. Note that, in the past two years, CBO scoring of the President's budget has resulted in consistently smaller savings estimates than OMB scoring.

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Aggregate Spending and Savings

Over the five year period 1998 - 2002, gross total Medicare spending⁴ in the President's budget would be about \$1.30 trillion. The President's budget claims to save \$100.2 billion over the five year period 1998 - 2002.

Growth Rates

Average Annual Growth Rates

	1997 - 2002 (5 year avg)	1995 - 2002 (7 year avg)
Nominal GDP	4.8 %	4.7%
Two times inflation	6.0 %	6.0%
Three times inflation	9.0 %	9.0%
Baseline Medicare growth (gross)	8.4%	8.4%
Baseline Medicare growth (net of premiums)	8.8%	9.0%
President's 1998 budget (gross)	6.5%	7.3%
President's 1998 budget (net of premiums)	6.3%	7.4%

⁴ "Gross total spending" includes \$13.6 billion over the five year period in discretionary spending for administration, and is before premium receipts are subtracted. The effect of Medicare on the deficit, "net total spending," is gross total spending minus premium receipts, and is shown in the functional table above. The summary tables at the beginning of this document show "gross mandatory spending," which is gross total spending minus discretionary spending.

Spending per Beneficiary

	CBO baseline	President's 1998 budget
1997 spending per capita (gross total)	\$5,540	\$5,540
2002 spending per capita (gross total)	\$7,850	\$7,400
Increase in spending per capita	\$2,310	\$1,860
Percent change	+42%	+34%
Average annual percent change	+7.2% / year	+6.0% / year

Home Health Transfer

Like last year, the President's budget proposes to transfer some home health spending from Medicare part A to Medicare part B. The amount transferred equals \$82 billion over the five year period 1998-2002, compared with \$55 billion over a six year period last year. Such a transfer contributes substantially to the solvency of the part A trust fund, but has no real effect on the financial health of the Medicare program as a whole.

There are two interesting policy effects that, surprisingly, do not accompany this transfer: (1) the transferred spending is not included in the calculation of the part B premium; and (2) there is no copayment imposed, as there is for almost all other part B services. By not including the transferred spending in the calculation of the premium, the transfer creates a new \$21 billion burden on general revenues.

Solvency of the Part A Trust Fund

The President's budget claims, using scoring from the Office of the Actuary and the OMB, to delay insolvency of the part A trust fund from 2002 until "early in calendar year 2007." There are several concerns, both with this goal and with this claim:

1. The President's stated goal is to keep the trust fund solvent for "a decade." Last year, the goal was "more than a decade." In addition, the President's budget is a proposal for *fiscal* year 1998, which begins October 1, 1997. A decade from October 1, 1997 is October 1, 2007. And yet the Administration's actuaries say the part A trust fund would be insolvent "early in *calendar* year 2007." Thus, even *with* the home health transfer and *before* CBO scoring, the President's budget fails to meet its own stated solvency goal by more than half a year.

2. The OMB baseline is (slightly) different from the CBO baseline, and CBO has not scored the Administration's proposals. These two differences may lead CBO to a different conclusion about the projected date of insolvency.
3. The President's budget proposes to transfer \$82 billion over five years from Medicare part A to Medicare part B. This policy extends the solvency of the part A trust fund, but has no real effect on the Medicare program.

Long-Term Reforms

There are no policies in the President's budget which would have any significant beneficial impact on the long-term financial sustainability of the Medicare program. Notably absent are: (1) increasing the age of eligibility for Medicare benefits; (2) implementation of a defined contribution framework emphasizing privately-offered insurance options; (3) reversing the "upside-down" structure of beneficiary cost sharing; and (4) any structure to encourage today's workers to save for their own future health care needs.

The President's budget goes in opposite directions with respect to structural reform. While it increases the range of managed care options for Medicare beneficiaries to include Provider Service Networks (PSNs) and a government-run Preferred Provider Organization (PPO), it excludes other choices, including privately offered fee-for-service plans; union, Taft-Hartley, and association plans; and medical savings accounts (MSAs). The President's plan can succinctly be described as "an expansion of Medicare managed care," while the reforms proposed in the 104th Congress could be described as "expanding Medicare to include a range of privately offered insurance choices, including, but greater than, an expansion of Medicare managed care options."

At the same time that it adds two new managed care options, the President's plan would decrease participation in managed care by reducing payments to Medicare HMOs. This is more fully described in the next section.

Payments to Medicare HMOs

The President's proposals for changing payments to Medicare HMOs are based on the assumption that Medicare HMOs are overpaid in two different ways. It is interesting that in one case, the savings are respent, and in the other, they are not.

Under current law, a Medicare HMO receives a payment equal to 95 percent of spending for an average beneficiary in fee-for-service Medicare in that geographic area. The President's budget would reduce this, beginning in 2000, to 90 percent. The Administration projects this change would save \$6 billion in the three year period 2000-2002. The debate about appropriate

risk adjustment is too lengthy and complex for discussion here. It is certain, however, that such a reduction would retard the movement of Medicare beneficiaries into Medicare managed care.

Although the original purpose of Medicare was “to remove financial barriers to health care for elderly Americans,”⁵ the Medicare program spends significant amounts of money to subsidize health facilities nationwide. By including this spending in Medicare, 95 percent of this non-benefit spending is included in the benefit payment to a Medicare HMO. The Administration proposes to remove this spending from calculation of the payment to a Medicare HMO. Thus, the payment would be calculated as a percentage of *benefit* spending for an average fee-for-service Medicare beneficiary in that geographic area. This issue can be separated from the above question of the appropriate rate (95 percent vs. 90 percent). The President’s budget then proposes to respend the money saved to further subsidize hospital infrastructure, specifically for teaching hospitals and for HMOs with residency programs.

Beneficiary Impact

The Medicare part B premium currently covers 25 percent of per capita part B spending. Under current law, this share will begin to decline in 1999, down to 16 percent ten years from now. The President’s budget proposes to permanently lock in the 25 percent level past the year 1998.

When Medicare was enacted in 1965, the part B premium covered 50 percent of part B program costs. Over time, this declined to 31.5 percent in 1995, and then to 25 percent on January 1, 1996. The President’s budget proposes to extend indefinitely the current (25 percent) premium rate. In the 1995 Balanced Budget Act, the Congress tried to extend indefinitely the 31.5 percent premium rate which was at that time the current rate. The President vetoed this proposal.

The President’s budget does not propose to relate the Medicare premium to income. In 1995, the Balanced Budget Act, the House “Blue Dog” Coalition, and the Senate Bipartisan Group all included an affluence-tested part B premium for high-income Medicare beneficiaries.

The premium amounts for the President’s budget (the last line of this table) have been estimated from aggregate premium information provided in the President’s budget.

⁵ Prospective Payment Assessment Commission, “Medicare and the American Health Care System: Report to the Congress,” June 1996, 4.

Monthly Medicare Part B Premiums (in \$)

	1995	1996	1997	1998	1999	2000	2001	2002
Current Law	46.10	42.50	43.80	45.80	47.10	48.50	50.00	51.50
President (6/95)	46.10	43.70	47.00	51.00	56.00	63.00	69.00	77.00
BBA, vetoed (11/95)	46.10	51.40	54.90	58.60	62.80	70.70	77.20	84.60
President ⁶ (3/96)	46.10	43.70	45.50	49.50	53.40	59.50	64.60	70.40
GOP (1/96)	46.10	43.70	47.00	51.00	56.00	63.00	69.00	77.00
President (1/97)	46.10	43.80	44.30	47.40	51.00	54.60	58.90	64.50

The President's budget proposes one change to beneficiary cost-sharing: to reduce copayments on hospital outpatient services over time from 20 percent of charges to 20 percent of recognized costs. This will increase the utilization of outpatient services and will increase the deficit by \$6.8 billion over five years.

New Benefits

The President's budget proposes several benefit expansions, including mammography with no cost-sharing, mammograms for age 50 and over, and chiropractic services. The budget also includes an alzheimer's respite benefit, which is estimated at \$1.8 billion over the next five years, but could have phenomenally high long-term costs to medicare. The policy justification for waiving cost-sharing for some services and not others is unclear. Preliminary estimates of the spending increases in the President's medicare plan, including about \$6 billion of new benefit spending, range up to \$15 billion.

Changes to Provider Payments

The following table lists OMB scoring for the Administration's proposed changes to provider payments. Incremental changes to provider payment policies accounts for all of the savings in the President's budget, with the exception of extending the part B premium at 25 percent of program costs.

Scoring shown here is from OMB. CBO has historically scored some of these policies with less savings. In particular, the claimed savings from fraud and abuse enforcement may be questionable.

Savings, 1997-2002 (OMB)**Managed care**

Indirect effects of reductions in fee-for-service	\$18 billion
Take GME and DSH out of HMO payments	\$ 9 billion
Cut HMO payment rate from 95% to 90% of AAPCC, starting in 2000	\$ 6 billion

Subtotal, managed care	\$33.6 billion
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Hospitals

PPS market basket minus 1.0 percent, 1998-2002	\$11.4 billion
PPS-exempt market basket minus 1.5 percent, 1998-2002	\$ 3.2 billion
Update 1995 PPS capital payments for inflation	\$ 6.4 billion
Pay 85 percent of PPS-exempt capital costs	\$ 0.8 billion
Redefine hospital "transfers"	\$ 4.1 billion
Rural hospital spending	cost of \$ 1.0 billion
New payments to teaching hospitals & HMOs	cost of \$10.7 billion
Changes to graduate medical education	\$ 7.6 billion
Hospital outpatient policy changes	\$ 8.1 billion
Other hospital policy changes	\$ 2.9 billion

Subtotal, hospitals	\$32.8 billion
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Post-acute care

Home health payment reforms, including PPS	\$13.7 billion
transfer some home health spending to part B	NO REAL EFFECT
Skilled Nursing Facility policy changes	\$ 7.1 billion

Subtotal, post-acute care	\$20.8 billion
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Physicians

Single conversion factor and change physician updates	\$ 5.3 billion
Single payment for surgery	\$ 0.4 billion
Changes to control high-volume inpatient service	\$ 1.5 billion
Direct payment to physician assistants and nurses	\$ 0.6 billion
Change payment policies for outpatient drugs	\$ 0.8 billion

Subtotal, physicians	\$ 8.6 billion
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Other

Fraud and abuse enforcement	\$ 9.1 billion
Competitive bidding for labs and medical equipment	\$ 1.4 billion
Reduce updates for ambulatory surgical center fees	\$ 0.3 billion
Expand “Centers of Excellence” demonstration project	\$ 0.1 billion
Laboratory payment policy changes	\$ 0.1 billion
<hr/>	
Subtotal, other	\$11.0 billion
 Total, provider payment policy changes	 \$106.2 billion

FUNCTION 600: INCOME SECURITY

The income security function contains the: 1) major cash and in-kind means tested entitlements, 2) general retirement, disability and pension programs excluding Social Security and Veteran's compensation programs, 3) federal and military retirement programs, 4) unemployment compensation, 5) low income housing programs and 6) other low-income support programs. Function 600 is the fourth largest functional category after Social Security, defense, and interest on the federal debt.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	222.0	232.6	239.4	254.8	268.7	273.5	285.2
Outlays	226.0	238.9	247.5	256.4	266.2	269.3	280.0
Change from 1997:							
Budget authority	---	---	+6.8	+22.2	+36.1	+40.9	+52.6
Outlays	---	---	+8.6	+17.5	+27.3	+30.4	+41.1

Spending on function 600 in the President's budget is projected to increase by annual average rate of 4.2 percent over the next five years, which is slightly less than twice the rate of inflation over that same period.

Welfare Reform Implementation

- ▶ The 1998 President's Budget contains an allowance of \$16.1 billion in additional spending over five years for means tested welfare programs to offset programmatic changes enacted in last year's welfare reform bill. The effect of these changes would also increase Medicaid costs by \$5.2 billion, which appears in function 550. Also, the budget proposes a new special tax deduction, found in the revenue section, for employers hiring former welfare recipients. This tax deduction would cost \$0.6 billion over five years. The cumulative effect of these changes would decrease savings across all affected functions from the welfare reform bill by \$21.4 billion or over 40 percent.
- ▶ Of the \$16.1 billion, \$9.7 billion is requested to restore disabled noncitizens and refugee and asylee eligibility for the **Supplemental Security Income (SSI)**. An additional \$0.4 billion is proposed to allow noncitizens to retain **Food Stamp** benefits through the end of 1997.

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- ▶ The Budget proposes \$3.0 billion in changes to **Food Stamps** reversing policies enacted in last year's welfare reform bill. These changes include: increasing the shelter deduction, reindexing the standard deduction, increasing and then reindexing the vehicle asset limitation, and increasing work slots and wage supplementation for the 18-50 able bodied work requirement.
- ▶ The President's proposal creates a new \$3.0 billion grant program to states and localities to help move welfare clients into jobs. The proposal provides states with \$1 billion a year for three years, 1998-2000. This funding is found in function 500.
- ▶ The welfare proposal would also rescind the states' option to withhold **Medicaid** from noncitizens who arrive after enactment of the welfare bill.

Other Low Income Assistance Programs

- ▶ The President's budget proposes increasing the **Federal Unemployment Tax (FUTA)** ceiling after 2000 which saves \$0.6 billion between 2000 and 2002. Also, the budget proposes \$0.9 billion in savings from **unemployment compensation** by reducing benefits and improving management of the program. The **NAFTA Trade and Adjustment Assistance (TAA)** program would be extended, costing \$0.1 billion between 1999 and 2002.
- ▶ The President's budget increases funding for the Special Supplemental Food Program for **Women, Infants and Children (WIC)** by \$233 million or 6 percent increase over the 1997 funding level of \$3.9 billion. In addition to the increase, the budget proposes a new \$100 million contingency fund that will be used if food cost inflation exceeds projected levels. This funding level would support a year-end caseload of 7.5 million.
- ▶ Included in the budget is a request for a \$100 million supplemental **WIC** appropriation for 1997 to avoid large participation drops. Even with this supplemental request, the program level is not sufficient to support the caseload in all states.
- ▶ The Administration proposes level funding of \$1.0 billion the **Low-Income Home Energy Assistance Program (LIHEAP)** in 1998.

Housing Assistance

- ▶ The budget proposes a funding level of \$20.1 billion for discretionary housing programs in this function for 1998, an increase of \$4.9 billion, or 32 percent, from the 1997 level.

- ▶ However, of the total amount requested for 1998, \$9.2 billion is for renewal of 1.8 million expiring **Section 8** contracts that are currently under payment, which is \$5.6 billion more than the amount appropriated to renew just 0.8 million expiring contracts in 1997. This means that the remainder of the housing appropriations request -- \$10.9 billion -- represents a 6 percent decrease from the 1997 level. Another way to look at it is to note that outlays under the President's proposal would increase only 1.3 percent from the 1997 level of \$28.9 billion.

Railroad Retirement

- ▶ The President proposes to increase benefits for retired railroad workers by \$0.2 billion over the period 1998 to 2002.
- ▶ Although railroad retirement and social security were coordinated in 1974, the Railroad Retirement Board continues to administer social security benefits for retired railroad workers, and there remain a few benefit anomalies, including certain social security benefits that railroad retirees do not get.
- ▶ The President's proposal would give these benefits to railroad workers while maintaining the separate administration at the Railroad Retirement Board.

Federal Retirement

- ▶ The budget proposes to resume the three-month delay in **cost-of-living adjustments** (COLAs), from January to April for the years 1998 through 2002, for federal civilian and foreign service retirees, saving \$1.5 billion over the five year period.
 - The 1993 budget reconciliation act delayed civilian retirement COLAs until April for the years 1994 through 1996, but COLAs were paid in January in 1997.
- ▶ There are two provisions in the budget affecting **agency contributions** to the **civil service retirement** fund:
 - The first requires agencies to increase their contributions for **civil service retirement system (CSRS)** employees by 1.51 percentage points beginning October 1, 1997 and ending September 30, 2002, saving \$3.0 billion over the period 1998 to 2002.
 - At the same time, the Administration proposes lower federal pay raises, which reduces agency retirement contributions by a corresponding amount.

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- These changes are reflected in the estimates for function 950 (offsetting receipts).
- ▶ The budget also proposes to increase **employee contributions** to both CSRS and **federal employees retirement** (FERS), increasing revenues by \$1.8 billion over the period 1998 to 2002 (these estimates are reflected in the revenue section).
 - The budget proposal would increase the employee contribution rate by 0.25 percentage points on January 1, 1999, another 0.15 percentage points on January 1, 2000, and another 0.10 percentage points on January 1, 2001. The higher contribution rate would expire on December 31, 2002.
- ▶ The budget request includes no changes to **military retirement benefits**.

MAJOR MANDATORY INCOME SECURITY PROGRAMS
(baseline projections, outlays in billions)

	1996	1997	1998	1999	2000	2001	2002
	Actual						
Projected Spending in 1998 Budget:							
Civilian Retirement	40.1	41.9	43.6	45.7	47.7	49.7	52.0
Military Retirement	28.8	30.1	31.3	32.4	33.5	34.5	35.5
Unemployment Comp	22.4	22.6	24.3	25.7	26.8	27.9	28.9
Food Stamps	25.4	24.9	25.9	26.8	27.6	28.3	29.6
EITC (outlays)	19.2	21.2	22.0	22.9	23.8	24.6	25.5
SSI	24.1	26.8	27.2	28.6	31.8	28.4	31.9
Temp Asst for Needy Families							
TANF (AFDC)	16.7	19.5	20.6	21.2	21.2	21.2	21.3
Change from 1997:							
Civilian Retirement		1.8	3.5	5.6	7.6	9.6	11.9
Military Retirement		1.3	2.5	3.6	4.5	5.5	6.5
Unemployment Comp		0.2	0.8	2.2	3.3	4.4	5.4
Food Stamps		-0.5	0.4	1.4	2.2	2.9	4.2
EITC (outlays)		2.0	2.8	3.7	4.6	5.4	6.3
SSI		2.7	3.1	4.5	7.7	4.3	7.8
Family Support Pmts							
(AFDC)		2.8	3.9	4.5	4.5	4.5	4.6

FUNCTION 650: SOCIAL SECURITY

This function -- the largest in terms of outlays in the federal budget -- includes Social Security benefits, or old age, survivors and disability insurance (OASDI). Social Security is also the largest entitlement program. Benefits are paid from the Social Security trust funds and financed by payroll taxes. For purposes of the Budget Enforcement Act, the Social Security trust funds are off-budget and do not count toward deficit projections. However, the administrative expenses of the Social Security Administration are on-budget and remain within the caps on overall discretionary spending.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	352.1	367.3	385.8	403.6	422.8	443.1	465.0
Outlays	349.7	367.7	384.3	402.0	421.1	441.2	463.0
Change from 1997:							
Budget authority	---	---	+18.5	+36.3	+55.5	+75.8	+97.7
Outlays	---	---	+16.6	+34.3	+53.4	+73.5	+95.3

- ▶ The budget proposes no direct change in Social Security benefits. Social Security spending increases an average of 4.7 percent annually over the 1997 to 2002 period.
 - ▶ The budget requests an increase in funding for the administrative expenses of the Social Security Administration (SSA), which became independent of the Department of Health and Human Services on March 1, 1995.
 - ▶ Overall, the budget requests \$6.5 billion for SSA, or \$0.1 billion (1.8 percent) above the 1997 level. The budget proposes a modest decrease in staffing levels at SSA, from 64,881 FTEs in 1997 to 64,696 FTEs in 1998, a decrease of 185 FTEs.
 - ▶ In 1996, Congress authorized special adjustments to the discretionary spending limits to accommodate additional resources for SSA to process **continuing disability reviews (CDRs)** for disabled Social Security and Supplemental Security Income beneficiaries and to process **reviews of eligibility** for certain categories of SSI beneficiaries, as required by welfare reform.
- For 1998, the authorized adjustment is \$470 million in outlays. This adjustment assumes an additional \$200 million in outlays is in SSA's regular appropriation for

CDRs and reviews of eligibility, and this \$200 million is counted against the discretionary spending limit.

- The President's budget requests an adjustment to the discretionary spending limit of \$290 million in outlays (\$180 million below the authorized amount) for these CDRs and reviews of eligibility. SSA estimates this level of funding will finance 1.1 million CDRs in 1998, up from 0.5 million in 1996.
- The budget proposes a pilot program to test a new approach to encouraging disabled Social Security and SSI beneficiaries to return to work. Beneficiaries could select from both private and public vocational rehabilitation agencies, and these agencies would share in any savings associated with moving persons off of the benefit rolls and into the workforce. The program is estimated to cost \$16 million over the period 1998 to 2002.

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FUNCTION 700: VETERAN AFFAIRS

This function includes all programs directed toward veterans of the armed forces. Income security needs of disabled veterans, indigent veterans and the survivors of deceased veterans are addressed through compensation benefits, pensions, and life insurance programs. Major education, training, and rehabilitation and readjustment programs include the Montgomery GI Bill, the Veterans Educational Assistance Program, and the Vocational Rehabilitation and Counseling program. Veterans are also able to receive guarantees on home loans and farm loans. Roughly half of all spending on veterans is for the Veterans Health Administration, which comprises over 700 hospitals, nursing homes, domiciliaries, and outpatient clinics.

	(\$ Billions)						
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	38.8	39.4	41.2	41.7	42.2	42.7	43.2
Outlays	37.0	39.7	41.0	41.9	43.9	41.2	43.4
Change from 1997:							
Budget authority	---	---	+1.8	+2.3	+2.8	+3.3	+3.8
Outlays	---	---	+1.3	+2.2	+4.2	+1.5	+3.7

Just over 50 percent of the Department of Veterans Affairs budget is spent on entitlement Compensation, Pension and readjustment and education programs. In 1998, entitlement programs are projected to cost \$22.4 billion in outlays. Of the total VA spending request, about 44 percent or \$18.1 billion goes to operating the medical care system and facilities construction which are subject to annual appropriations.

Mandatory Proposals

The President's Budget proposes \$1.6 billion over five years in net mandatory savings from changes to veteran compensation and education. This total includes the cost of converting offsetting collections to discretionary spending. These changes are apart from the annual COLA increase for VA compensation which is assumed in the baseline.

Compensation Proposals

- ▶ The proposal permanently extends expiring provisions of law. These extensions include 1) limiting pensions for veterans in Medicaid nursing homes, 2) income verification for

recipients of pensions and medical care, 3) home loan fees and reduction in resale losses, 4) recovery of health care costs from third party insurers for non-service connected care, and 5) the authority to collect prescription co-pays and other medical care per diems. Saves \$4.2 billion over five years.

- ▶ The Budget also proposes to round down compensation cost-of-living adjustments to nearest whole dollar and extend the Dependency and Indemnity Compensation (DIC) COLA rate to all DIC recipients. Saves \$0.2 billion over five years.
- ▶ Finally, the budget proposes to allow the Secretary to use income tax refunds and federal wages to offset loan guaranty debts, which saves \$0.1 billion all in 1998
- ▶ After the proposed entitlement changes, total compensation and pension spending is projected to be \$19.7 billion in 1998, an increase of 1.6 percent over 1997.
- ▶ An average of 2.3 million veterans and 0.3 million survivors received compensation benefits in 1997. Of the 2.3 million veterans receiving compensation, 1.6 million veterans had disabilities rated at or below 30 percent. One-third of all payments went to the 0.2 million veterans with 100 percent disability ratings. An average of 0.4 million veterans and 0.3 million survivors received VA pension benefits.

Medical Programs

- ▶ The Administration proposes to allow VA medical centers to keep third party health insurance payments and other fees for non-service connected care from the existing **Medical Care Cost Recovery (MCCR)** fund. This change would allow VA hospitals -- which are classified under discretionary spending -- to have higher levels of resources without additional amounts of discretionary spending. This provision would cost \$2.0 billion over five years.
- ▶ The President's proposal to allow the VA to retain collections in the MCCR would increase total resources for **VA medical programs** by 3.2 percent or \$537 million over the 1997 enacted level of \$17.0 billion, to \$17.5 billion. However, spending subject to the discretionary caps would decrease by \$55 million to just under \$17 billion. These resources pay for medical care in 173 VA hospitals, 133 nursing homes, 398 outpatient clinics and 40 domiciliaries.
- ▶ The average daily census of patients in all VA inpatient facilities, including acute care hospitals, nursing home and residential care, is estimated to continue decreasing in 1998, from 73,302 average daily patients in 1997 to 72,134 average daily patients -- a 1.6 percent decline. The average daily census has dropped 15 percent since 1995. The daily

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census for nursing homes, however, is projected to increase by 694 patients from 35,182 in 1997 to 35,876 in 1998.

- ▶ The President's request also includes \$234 million for **medical and prosthetic research**, which is a decrease of \$28 million from the 1997 funding level.

Construction Programs

- ▶ The Administration requests \$277.9 million for construction programs. **Major construction** programs -- projects estimated to cost over \$3 million -- would be funded at \$79.5 million for 1998. No facilities are proposed to be closed.
- ▶ The major construction budget would finish a hospital project in Memphis, and cemetery projects in Cleveland, Fort Sam Houston, Texas, and Arizona. No new projects would be started.
- ▶ **Minor construction** -- improvement and maintenance projects under \$5 million -- would be funded at \$166 million in 1998, \$9 million less than the 1997 level of \$175 million. The minor construction would aid the current restructuring program moving from an in-patient hospital-based system to outpatient care and support. Legislation is included to increase the minor construction threshold to \$5 million.

FUNCTION 750: ADMINISTRATION OF JUSTICE

This function includes funding for federal law enforcement activities, including criminal investigations by the Federal Bureau of Investigation (FBI) and the Drug Enforcement Agency (DEA), border enforcement and the control of illegal immigration by the Customs Service and the Immigration and Naturalization Service (INS), as well as funding for prison construction, drug treatment, crime prevention programs and the federal Judiciary. The function includes resources for the Violent Crime Reduction Trust Fund (VCRTF) into which were deposited assumed annual savings from reducing the federal workforce between 1995 and 2000. The trust fund will expire in 2000.

	(\$ Billions)						
	1996 Actuals	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	21.1	23.8	24.9	25.6	24.8	25.2	25.9
Outlays	17.5	20.8	24.2	25.9	26.4	26.1	26.0
Change from 1997:							
Budget authority	---	---	+1.1	+1.8	+1.0	+1.4	+2.1
Outlays	---	---	+3.4	+5.1	+5.6	+5.3	+5.2

- ▶ Through the **Violent Crime Reduction Trust Fund**, the President requests an additional \$1.4 billion in seed money to fund the **Community Oriented Policing Services** (Cops on the Beat). The Administration claims that this would allow the hiring of an additional 17,000 officers for a total of 64,000 policemen, moving toward the President's stated goal of putting 100,000 new cops on the beat.
- ▶ The request would decrease by \$363 million the Office of Justice Assistance programs, which funds programs for states and localities including **COPS, Byrne Grants and Juvenile Justice** programs.
- ▶ The Administration requests \$3.6 billion for the **Immigration and Naturalization Service**, a 13 percent increase from 1997. This includes an increase of \$44 million in new budget authority for **salaries and expenses**, a 2.7 percent increase over the 1997 level of \$1.607 billion. Of the total INS request, \$1.2 billion would come from offsetting fees, and \$732 million is funded by the VCRTF.

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- ▶ To combat illegal immigration, the President requests \$818 million for **border patrol activities**, an increase of \$282 million from 1996. The President plans to use this funding for an additional 500 Border Patrol agents and also intends to deploy 50 new INS support personnel. Total Border Patrol agents is projected to be 7,359 by the end of the year to go along with 1,493 support personnel. Land Border inspectors will remain constant at 1,885 inspectors.
- ▶ To fight **drug abuse and drug-related crime**, the Administration requests \$16.0 billion for domestic drug enforcement, an increase of \$818 million or 19% from 1997 level of 15.2 billion. The drug control request is split between Demand Reduction (\$5.5 billion) and Supply Reduction (\$10.5 billion.)
- ▶ The President seeks \$1.019 billion for the salaries and expenses of **U.S. Attorneys**, an 8.1 percent increase of \$76 million over the 1997 level. The Administration also requests \$51 million for U.S. Attorneys from the **Violent Crime Reduction Trust Fund**.
- ▶ The Administration seeks \$340 million for the **Legal Services Corporation**, a \$57 million increase over the 1997 funding level of \$283 million.
- ▶ The Administration seeks to reduce new funds available for prison construction, repair and modernization, while increasing salaries and expenses within the current federal prison system. The Administration requests \$253 million in new budget authority in the **Building and Facilities account**, a \$143 million decrease from the 1997 level of \$396 million. This request will support building a new high and minimum security facility at Castle Air Force Base, California. The Administration however proposes \$2.97 billion for **federal prison salaries and expenses**, a 7.2 percent or \$198 million increase from 1997. This level of funding will support the custody of an average of 101,610 inmates, 99 penal institutions, 6 regional offices, 3 staff training centers as well as central office activities. An additional 11,945 inmates will be housed in contract facilities.
- ▶ The President requests an increase of \$387 million for **the federal Judiciary**, a 11.5 percent increase over the 1997 level of \$3.4 billion. This includes a \$20 million increase from the **Violent Crime Reduction Trust Fund** for programs created by the 1994 Crime bill.
- ▶ The Budget proposes taking full advantage of the \$5.5 billion authorized for the **Violent Crime Reduction Trust Fund** in 1998 created by the 1994 Crime Bill.

FUNCTION 800: GENERAL GOVERNMENT

This function consists of the activities of the Legislative Branch, the Executive Office of the President, U.S. Treasury fiscal operations (including tax collection), personnel and property management, and general purpose fiscal assistance to states, localities, and U.S. territories.

(\$ Billions)							
	1996 Actual	1997	1998	1999	2000	2001	2002
President's Budget:							
Budget authority	11.6	12.9	13.6	13.3	13.0	12.9	13.1
Outlays	11.9	13.1	12.9	13.2	13.6	13.0	13.0
Change from 1997:							
Budget authority	---	---	+0.7	+0.4	+0.1	+0.0	+0.2
Outlays	---	---	-0.2	+0.1	+0.5	-0.1	-0.1

The President's budget for Function 800 proposes a takeover of many of the District of Columbia's services in lieu of the annual federal payment. The President also requests \$700 million in new funding for the IRS in 1998.

- ▶ President Clinton has proposed that the federal government relieve the District of Columbia of substantial financial and managerial responsibilities, which the administration estimates will cost \$339 million over the first five years. In addition to the takeover of services, the President has proposed that the government assume responsibility for the District's existing pension plans for law enforcement officers, firefighters, teachers, and judges. Under this portion of the plan, the federal government will face mandatory pension payments of \$2.3 billion over 1998-2002, but it will also receive a reimbursement from the District's pension assets of an equal amount. These assets will be exhausted by 2007, leaving the federal government to pay a \$4.3 billion unfunded liability. The mandatory payment in 2007 is \$667 million.
- ▶ Under the President's District of Columbia plan, the federal government will invest \$3.9 billion in the nation's capital over five years, some of which is spread across other functions. This amount includes \$1.8 billion to operate and renovate prisons, \$681 million to operate the court system, \$125 million in 1998 to rebuild the city's transportation infrastructure, \$117 million to improve tax collection, \$917 million to increase the federal share of Medicaid payments (Function 550), and \$260 million for tax incentives for economic development (Revenues). This extra spending is conditional on the District

balancing its budget by 1998. In exchange for this increased activity, the plan will terminate the yearly federal appropriation and other payments to the District, saving \$3.6 billion over five years. Because some of the new benefits appear elsewhere in the budget, function 800 spending is nearly \$1.2 billion lower over the period 1998-2002 than it would be otherwise.

- ▶ President Clinton is requesting a 10 percent increase for the **Internal Revenue Service (IRS)**, the largest agency in the Treasury Department. Funding for the IRS would increase from \$7.2 billion in 1997 to \$7.9 billion in 1998.
- ▶ The President is requesting \$1 billion in funding over 1998 and 1999 for new information technology investments for the IRS. The IRS recently admitted that after spending \$3.4 billion on the tax system modernization (TSM) program, it does not work as planned. GAO warned early on that the IRS had not clearly expressed how to link the computer technology to its tax collection procedures. A new management group formed to salvage the project conceded that the IRS lacked the “intellectual capital” to develop modern computer systems and proposed contracting out some tax-return processing. Despite their problems, the IRS is being asked to takeover a significant part of the District’s tax collection activities.
- ▶ The budget submission includes nearly \$1 billion over five years in new mandatory funding for job training assistance in Puerto Rico.
- ▶ The President is requesting a \$133 million increase, or 61 percent, in 1998 for drug control programs.

Payment of Claims and Savings & Loan Baseline Issue

- ▶ Last year the Supreme Court upheld an earlier ruling that a 1989 federal law broke a contract between a savings and loan institution and the Federal Savings and Loan Insurance Corporation. This ruling is expected to cost the federal government from \$10-20 billion. The federal agency had encouraged healthy S&Ls to buy ailing S&Ls with the promise that the buyer could employ favorable accounting treatment of “supervisory goodwill.” The subsequent 1989 law reversed that agreement, costing S&Ls millions and causing many to fail.
- ▶ In spite of last year’s Supreme Court ruling, the President does not include any amount in his budget for settlement costs. CBO, on the other hand, has included \$1.5 billion per year of spending in its baseline, or \$9 billion over the 1997-2002 period.

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

This function records offsetting receipts (receipts, not federal revenues or taxes, that the budget shows as offsets to spending programs) that are too large to record in other budget functions. Such receipts are either intrabudgetary (a payment from one federal agency to another, such as agency payments to the retirement trust funds) or proprietary (a payment from the public for some type of business transaction with the government). The main types of receipts recorded as “undistributed” in this function are: the payments federal agencies make to retirement trust funds for their employees, payments made by companies for the right to explore and produce oil and gas on the Outer Continental Shelf, and payments by those who bid for the right to buy or use the public property or resources, such as the electromagnetic spectrum.

	(\$ Billions)						
	1996 Actual	1997	1998	1999	2000	2001	2002
President’s Budget:							
Budget authority	-37.6	-46.5	-55.6	-43.5	-46.0	-50.1	-68.0
Outlays	-37.6	-46.5	-55.6	-43.5	-46.0	-50.1	-68.0
Change from 1997:							
Budget authority	---	---	-9.1	+3.0	+0.5	-3.6	-21.5
Outlays	---	---	-9.1	+3.0	+0.5	-3.6	-21.5

Under the budget request, undistributed offsetting receipts are expected to increase by \$9.1 billion in 1998. Most of the increased receipts over the period would stem from new spectrum auctions.

Spectrum Auctions

- ▶ Under this heading, the President’s budget assumes \$36.1 billion in new receipts can be collected over the next five years, with \$22.1 billion, or 61 percent, of the total appearing in 2002 alone.
- ▶ The President’s budget assumes enactment of the provisions included in the vetoed Balanced Budget Act that would extend and broaden the current authority (which will expire at the end of 1998) of the Federal Communications Commission (FCC) to auction parts of the electromagnetic spectrum, generating \$17.1 billion in receipts. In addition, the President would direct the FCC to reallocate a portion of spectrum, currently used for

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television broadcast channels 60-69, to other purposes and auction it, yielding \$3.5 billion in receipts over 2001-2002.

- ▶ Further, the President's budget assumes \$14.8 billion of receipts in 2002 alone from the advance sale of a specific part of the spectrum. The President would accelerate the current plan of the FCC to require television broadcasters to transition from existing analog technology to digital technology. The proposal would mandate that broadcasters turn off their analog signal in 2005 and give the corresponding spectrum back to the federal government, which would auction it in advance in 2001, at least five or six years before the bidders could possibly hope to obtain use of the spectrum.
- ▶ To the extent that a significant portion of the public would not yet have new digital televisions to receive the new digital signal when the analog signal is turned off, the President's budget contemplates requiring broadcasters to pay into a fund that would subsidize half the cost (estimated to be \$50 to \$100) of converter boxes that would allow a digital signal to be viewed on an analog TV.
- ▶ In addition, because the Congressional Budget Office estimates that the proposal to auction this spectrum in time to produce receipts exactly in 2002 would yield significantly less than the President expects, the budget would also require that any "shortfall" less than \$14.8 billion in actual auction receipts be made up by a fee that the FCC would charge to broadcasters for use of the spectrum for their digital signal. Although there is no legislative language that would show how this would occur, the shortfall, say \$4 billion to \$6 billion, would probably have to be measured and then extracted in the latter half of 2002 and would probably appear as a tax in the budget.
- ▶ Finally, while strictly not a spectrum proposal, the budget includes a proposal for the FCC to auction the rights to use toll-free 888 phone numbers, estimated to generate \$0.7 billion in receipts in 1998.

Federal Employees

- ▶ As discussed in Function 600, the President's budget includes several proposals affecting federal employees, and thereby affecting intragovernmental payments that appear in this function. First, the President would shrink federal pay raises and therefore lower associated contributions by federal agencies on behalf of employees to the Civil Service Retirement and Disability fund, resulting in decreased payments of about \$3 billion over the 1998-2002 period. Almost exactly offsetting this effect, however, is the President's proposal that agencies increase their contribution to the retirement fund, producing almost \$3 billion in additional payments to the fund over the next five years.

FEDERAL DEBT AND INTEREST COSTS

Outlays for net interest represent the gross cost of financing all federal government debt, less interest earned by federal government on its trust fund investments and on loans to the public.

Net interest spending is not directly controllable by policy actions. Interest spending depends on the level of debt and on interest rates. Congress and the President control the level of debt through decisions about spending and taxation. Interest rates are determined by market forces and Federal Reserve policy. The President's economists assume that balancing the budget will precipitate market and Federal Reserve action to reduce both short- and long-term interest rates.

INTEREST COSTS AND THE PUBLIC DEBT (\$ Billions)

	1996	1997	1998	1999	2000	2001	2002
Interest Outlays:							
Interest on public debt (gross)	000.0	346.1	347.3	350.3	352.3	353.1	355.1
Interest rec'd by trust funds:							
Social Security	-00.0	-39.4	-42.4	-45.5	-48.9	-52.6	-56.6
Other trust funds a/	-00.0	-61.8	-62.8	-63.7	-66.3	-65.3	-66.6
Other interest received b/	-0.0	-6.5	-6.0	-6.5	-7.3	-8.2	-8.6
Net interest on public debt	241.1	247.4	249.9	251.8	248.2	245.0	238.8
Federal Debt, End of Year:							
Gross Federal Debt	5,182	5,454	5,736	6,013	6,272	6,485	6,653
Debt Held by Gov't. Accts.	1,449	1,578	1,715	1,853	2,003	2,157	2,319
Debt Held by the Public	3,733	3,876	4,021	4,159	4,269	4,328	4,333
Debt Subject to Limit c/	5,137	5,411	5,697	5,973	6,233	6,447	6,615
Federal Debt as a Percentage of GDP:							
Gross Federal Debt	69.2%	69.4%	69.8%	69.8%	69.4%	68.0%	66.8%
Debt Held by the Public	49.9%	49.3%	48.9%	48.3%	47.2%	45.6%	43.5%

a/ Includes Civil Service Retirement, Military Retirement, Medicare, unemployment insurance and the Highway and Airport and Airway trust funds.

b/ Primarily interest on loans to the public and to the RTC and Bank Insurance Fund.

c/ Differs from gross federal debt because most debt issued by agencies other than Treasury is excluded from the debt limit.

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- ▶ The President's budget includes net interest outlays of \$249.9 billion in 1998, falling to \$238.8 billion by the year 2002. Net interest outlays currently make up 15.5 percent of total federal outlays; by 2002, under President Clinton's budget, net interest outlays would make up 12.7 percent of total spending.
- ▶ President Clinton proposes to increase total federal debt by \$1.47 trillion and debt held by the public by \$600 billion by the year 2002. As a share of the total economy, federal debt will remain near 70 percent of GDP through the year 2000, before falling to about 67 percent of GDP by the year 2002.
- ▶ Interest costs in the President's budget in 2002 are \$ billion below current services interest costs. This reflects savings due to the lower post-policy interest rate assumptions, as well as explicit policy decisions to reduce the deficit.
- ▶ The statutory debt limit today stands at \$5.5 trillion. Under the President's budget projections, debt subject to limit will equal \$5.411 trillion at the end of fiscal year 1997 and \$5.697 trillion at the end of fiscal year 1998.

Deficit Reduction Fund

- ▶ The budget devotes attention to the Deficit Reduction Fund that was created by executive order on August 4, 1993. The order required that amounts equal to the deficit reduction resulting from OBRA93 be credited to the fund, and that fund balances be used exclusively to redeem maturing debt obligations of the Treasury held by foreign governments.
- ▶ Between October 1, 1993, and December 31, 1996, \$ billion of Treasury debt held by foreign governments was redeemed by balances in the Deficit Reduction Fund. *Exactly the same amount would have been redeemed had there been no Deficit Reduction Fund.* Between October 1, 1993, and December 31, 1996, the total public debt outstanding increased by more than \$1.2 trillion. *The public debt outstanding would have increased by the exact same amount had there been no Deficit Reduction Fund. The Deficit Reduction Fund has no effect on overall spending or revenues, and does not influence the level of the deficit or debt at all.*

REVENUES

Federal revenues are taxes and other collections from the public that result from the government's sovereign or governmental powers. This section provides an overview of President Clinton's revenue proposals for the period 1997-2002. Revenues in the Clinton budget are expected to grow by \$391.3 billion between 1997 and 2002.

(\$ Billions)							
	1996 Actuals	1997	1998	1999	2000	2001	2002
President's Budget:							
Revenues	1453.1	1505.4	1566.8	1643.3	1727.3	1808.3	1896.7
Change from 1997:							
Revenues	---	---	+61.4	+137.9	+221.9	+302.9	+391.3

The Middle Class Tax Cuts

The President proposes a **tax credit of \$300 per child** (\$500 per child when fully phased in) for children under the age of 13, phased out for families with AGI between \$60,000 and \$75,000. The credit is slowly phased in--\$300 for 1997, 1998, and 1999, and \$500 for 2000 and beyond. Starting in 2001, the credit and the phase-out range would be indexed for inflation.

The President proposes **an education deduction** of up to \$5,000 per family in 1997 and 1998 for college or other post-high school education expenses. The deduction would increase to \$10,000 per family in 1999. It will be phased out for taxpayers filing jointly with modified AGI between \$80,000 and \$100,000. The President also proposes a nonrefundable **tax credit for education expenses** of \$1,500 per student for full-time tuition in their first year, and another \$1,500 in their second year if they maintain a B average and are not convicted of drug offenses. The credit would be available for education commencing after July 1, 1997. Students or their families could claim either the education deduction or the tax credit in a given year.

The President's budget would **extend the exclusion for employer-provided educational assistance** through December 31, 2000 (current set to expire May 31, 1997), and reinstate the

exclusion for graduate courses. The President would also provide **small business with a ten percent income tax credit** for payments for education of employees made under an employer-provided educational assistance program.

The President would double, over time, the current income limitation on deductible **Individual Retirement Accounts (IRAs)**. Under the President's proposal the income limitation would be raised to \$80,000 (phased out at \$100,000) for married taxpayers, and raised to \$50,000 (phased out at \$70,000) for individuals. The income thresholds and the present law annual contribution limit of \$2,000 would be indexed for inflation. The proposal would allow penalty-free withdrawals from IRA accounts to pay for post-secondary education, first time home buying, and unemployment expenses.

The plan would allow both front-ended IRAs in which a deduction is allowed when the contribution is made, or what the President calls a "**Special IRA**." The Special IRA is a back-ended IRA to which contributions are made with after-tax dollars but any withdrawals of interest or dividends are exempt from tax and penalties if the funds are kept in the IRA for at least five years.

Other Tax Cuts

President Clinton's 1998 budget contains a **small capital gains tax cut** proposal. Home sellers would be allowed to exclude up to \$500,000 (married taxpayers) in gain from the sale of a principal residence. The new exclusion would replace both the current "over-55" exclusion and the deferral for purchasing a more expensive home, and would be available once every two years. The change would be effective January 1, 1997.

The President proposes a **temporary welfare-to-work wage credit** which would enable employers to claim a 50 percent credit on the first \$10,000 of wages paid to workers (for up to two years) who had been on welfare for at least 18 months. The proposal also **expands the existing work opportunity wage credit** to include adults age 18 to 50 who are no longer eligible for food stamps because they did not satisfy the work requirements under the welfare reform bill.

The President proposes to allow owners of closely-held businesses to defer **estate taxes** on \$2.5 million of value (up from \$1 million under current law), and pay the taxes over 14 years. Form of business ownership would be irrelevant.

The President proposes a **brownfields tax incentive**. This proposal would allow immediate expensing of qualified environmental remediation costs to encourage companies to clean up contaminated properties. The President proposes to authorize 20 additional **empowerment zones** and 80 additional **enterprise communities**, with tax incentives including the brownfields initiative, additional small business expensing, and new private activity bonds.

President Clinton proposes to provide nonrefundable **tax credits to equity investors in qualified CDFI investments**. The Community Development Banking and Financial Institutions Act of 1994 created a federal CDFI fund to provide grants, loans, and technical assistance to qualifying lenders.

President Clinton proposes to provide the **District of Columbia tax incentives** to encourage employment and revitalize distressed areas, but the budget does not detail what the tax incentives would entail.

The President also proposes to **allow Foreign Sales Corporation (FSC) benefits for computer software licenses** for reproduction abroad. FSC provisions provide a limited exemption from U.S. tax for income arising in certain export transactions. These benefits are currently not available for most exports of intangible property, including computer software copyrights. FSC benefits are available for films, tapes, and records, and the Administration felt that software should qualify as well.

President Clinton would **temporarily extend several provisions** due to expire during the next year: the research and experimentation tax credit, the orphan drug tax credit, deduction for contributions of appreciated stock, and the work opportunity tax credit. These provisions would be extended for one year through May 31, 1998. The Puerto Rico economic-activity tax credit (formerly known as sec. 936) is modified and extended indefinitely. The President also extends the Generalized System of Preferences (**GSP**) through 2005, and modifies other trade provisions including expanded trade benefits to Caribbean Basin countries.

Sunset of Tax Cuts

The President's budget includes an unspecified mechanism to ensure that the plan reaches balance in 2002 under OMB or CBO economic assumptions. If the economy does not perform as OMB's assumptions project, then most of the tax cuts would be repealed.

Tax Increases

The President proposes a series of provisions that increase federal revenues. These include:

- ▶ A proposal to **deny corporate interest expense deductions for debt with a maturity longer than 40 years**.
- ▶ A proposal to **defer original issue discount deduction on convertible debt, treat certain preferred stock as boot, and a repeal of tax-free conversion allowed when large C corporations convert to S corporations**.

- ▶ A proposal to **reduce from 70 to 50 percent the dividends-received deduction (DRD), repeal the DRD for certain debt-like preferred stock, and modify the holding period for the DRD.** The DRD was specifically designed to eliminate one layer of taxation by making dividends largely non-taxable to the corporate owner.
- ▶ **Extending the pro rata disallowance of tax-exempt interest expense to all corporations.**
- ▶ **A requirement of average-cost basis for stocks, securities etc.** The Administration proposes to require taxpayers to determine their basis in substantially identical securities using the average of all their holdings in the securities.
- ▶ A proposal to **require recognition of gain on certain stocks, indebtedness and partnership interests, and to require gain recognition for certain extraordinary dividends.** The budget also contains a proposal to **require gain recognition in certain distributions of controlled corporate stock.**
- ▶ **A change in the treatment of gains and losses on extinguishment, and a requirement for reasonable payment assumptions for interest accruals on certain debt instruments.**
- ▶ A proposal to **repeal percentage depletion for non-fuel minerals** mined on Federal lands where the mining rights were acquired under the 1872 mining act, and on private lands acquired under the 1872 law.
- ▶ A proposal to modify the **loss carry-back and carry-forward rules** dealing with net operating losses (NOLs), as well as a proposal to **reform treatment of certain stock transfers.**
- ▶ Proposals to reform the foreign tax credit, including **expanding subpart F provisions regarding certain income, a modification of taxation of certain captive insurance companies,** a modification to **foreign tax credit carryback and carryforward rules** and a proposal to **replace sales source rules with activity based rules.** This proposal limits the 50-50 default rule for allocating export income between domestic production and foreign sales activities. The allocation will be based on actual economic activity.
- ▶ A modification to rules relating to **foreign oil and gas extraction income.** The proposal would limit the payments to foreign governments qualifying for the foreign tax credit.

- ▶ A phase-out of preferential tax deferrals for certain **large farm corporations**, and repeal of lower of “**cost**” or “**market inventory accounting**” and repeal of “**components of cost inventory accounting method.**”
- ▶ A proposal to **place further restrictions on like-kind exchanges** involving personal property. U.S. and foreign personal property could no longer be exchanged tax-free. Conforms rules for personal property to rules for real property. The budget would require **reporting of payments of corporations rendering services to federal agencies**, and would **tighten substantial underpayment penalty.**
- ▶ A proposal to **shorten the extension of section 29 (nonconventional source fuels) production credit.** Under current law, a \$3 per barrel credit applies to nonconventional source fuels sold before January 1, 2008 if produced from facilities placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997. The Administration proposes to modify the extension of the placed-in-service date by moving it to July 1, 1997; the binding contract date would not be modified.
- ▶ Proposals of a series of loophole closing provisions that were in the vetoed Balanced Budget Act. These include: expanding requirement that **involuntarily converted property** be replaced with property acquired from an unrelated party; requiring **registration of certain confidential corporate tax shelters**; requiring **tax reporting of payments to attorneys**; repealing exemption for **withholding on gambling winnings from bingo and keno** in excess of \$5,000; and, **increasing penalties for failure to file correct information returns.**
- ▶ A proposal to **tax kerosene as diesel fuel**, when it is removed from the terminal, effective July 1, 1998. Exceptions would be provided for aviation fuel and for feedstock uses. Special refund rules would apply in certain cases of kerosene used for heating.
- ▶ An extension of the FUTA surtax through 2007, and a requirement for monthly, instead of quarterly, payments of the **Federal Unemployment Act tax (FUTA)** beginning in the year 2002. This provision speeds up collections in the year 2002 by \$1.3 billion.
- ▶ Proposals to extend several expired excise taxes, including taxes dedicated to **Superfund; oil spill excise taxes, Leaking Underground Storage Tank (LUST) excise taxes, and airport and airway trust fund excise taxes.** All are extended until October 1, 2007. The budget would also extend the **corporate environmental tax** dedicated to Superfund.

Miscellaneous tax and fee increases

- ▶ The President's budget proposes to require **FDIC to assess fees** for examination of FDIC-insured state banks and bank holding companies. The budget proposes to assess **fees for NTSB aviation accident investigation**, establish **alien labor certification fees**, extend and increase **FDA user fees**, and initiate a **HCFA Medicare survey and certification fee**.
- ▶ A deficit neutral proposal to **modify the method of reimbursing fed banks**. Treasury would reimburse Federal Reserve Banks for services required by the Treasury; the Fed would in turn deposit the additional earnings back to Treasury.
- ▶ A proposal to give **IRS new authority to effect a continuous levy** on non-means tested federal payments received by individuals who owe delinquent tax debt.
- ▶ The President proposes to **increase employee contributions to CSRS and FERS**. This is discussed in the summary of function 600.

CLINTON TAX PROPOSALS
(\$ Billions)

	1997	1998	1999	2000	2001	2002	1997-02
Tax Relief Provisions:							
Child tax credit	-0.7	-9.9	-6.8	-8.6	-10.4	-10.4	-46.7
Expand IRAs	--	-1.5	-0.5	-0.8	-1.2	-1.7	-5.5
Tax incentives for higher education	-0.1	-4.0	-6.2	-7.8	-8.6	-9.4	-36.2
Welfare-to-work tax credit	--	-0.1	-0.1	-0.2	-0.1	-0.1	-0.6
Capital gains on home sales	-0.1	-0.3	-0.3	-0.3	-0.3	-0.2	-1.5
DC tax incentives	--	_*	_*	-0.1	-0.1	-0.1	-0.3
Small business estate tax relief	--	_*	-0.2	-0.2	-0.2	-0.2	-0.7
Incentives for distressed areas and CDFI	_*	-0.4	-0.5	-0.5	-0.5	-0.4	-2.4
Allow FSC benefits for software	_*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Exempt Fed. purch. from vaccine tax	--	-0.1	--	--	--	--	-0.1
Extension of expiring provisions:							
Employer-provided educational assis.	-0.1	-0.6	-0.7	-0.8	-0.2	--	-2.4
R&E tax credit	-0.4	-0.8	-0.5	-0.2	-0.1	_*	-2.1
Orphan drug credit	_*	_*	_*	_*	_*	_*	_*
Work opportunity tax credit	--	-0.1	-0.2	-0.1	_*	_*	-0.4
Contributions for appreciated stock	--	_*	_*	--	--	--	-0.1
Puerto Rico tax credit	--	_*	-0.1	-0.1	-0.1	-0.1	-0.4
GSP and other trade provisions	--	-0.7	-0.5	-0.6	-0.7	-0.8	-3.3
Subtotal, tax relief	-1.4	-18.7	-16.7	-20.3	-22.6	-23.5	-103.3
Revenue Raisers:							
Deny int. deduc.on certain debt instruments	*	0.1	0.1	0.2	0.2	0.3	0.8
Defer orig issue discount deduction	--	*	*	*	*	0.1	0.2
Limit dividends received deduction	--	0.3	0.4	0.4	0.4	0.5	2.0
Extend prorata disallowance to all corp	--	*	*	*	0.1	0.1	0.2
Require avg cost basis for stock/securities	--	0.6	0.6	0.6	0.6	0.6	3.0
Require recognition of gain on stocks, etc.	--	*	0.1	0.1	0.1	0.1	0.3
Require reasonable payment assumptions for interest accruals on debt instruments	--	0.1	0.2	0.3	0.3	0.2	1.1
Recognize certain extraordinary dividends	0.4	0.6	*	*	*	*	1.0
Repeal percentage depletion	*	0.1	0.1	0.1	0.1	0.1	0.5
Modify loss carry-back and -forward rules	*	0.1	0.6	0.8	0.7	0.6	2.9
Treat certain preferred stock as "boot"	*	0.1	0.2	0.2	0.2	0.1	0.8
Repeal taxfree conversions of C to S	--	*	*	*	*	*	0.1
Recog. gain in distrib. of corp. stock	*	0.1	0.1	0.1	0.1	0.1	0.4
Reform treatment of certain stock trans	*	0.1	0.1	0.1	0.1	0.2	0.7
Reform foreign tax credit	--	1.0	1.8	1.9	2.1	2.2	9.0
Modify foreign oil and gas extrac rules	--	*	0.1	0.1	0.1	0.1	0.4
Phase out tax deferral for large farms	*	0.1	0.1	0.1	0.1	0.1	0.7
Inventory reforms	0.1	0.3	0.5	0.6	0.6	0.4	2.4
Tax kerosene as diesel fuel	*	*	*	*	*	*	0.2

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Limit extension of sec. 29 tax credit	*	0.1	0.1	0.1	0.1	0.1	0.5
Other tax increase provisions	*	0.1	0.1	0.1	0.1	0.2	0.6
Extension of expired taxes and new fees:							
Extend oil spill tax	*	0.2	0.2	0.2	0.2	0.2	1.2
Extend FUTA surcharge	--	--	0.9	1.2	1.3	1.3	4.7
Accelerate FUTA deposit	--	--	--	--	--	1.3	1.3
Extend Superfund corporate tax	--	1.1	0.7	0.8	0.8	0.8	4.2
Extend Superfund excise tax	0.1	0.7	0.7	0.7	0.7	0.7	3.5
Extend LUST excise tax	*	0.1	0.1	0.1	0.1	0.1	0.6
Extend aviation trust fund taxes	2.3	5.0	6.7	6.6	6.8	7.0	34.5
Assess bank examination fee	--	0.1	0.1	0.1	0.1	0.1	0.4
Modify Fed bank reimbursement	--	0.1	0.1	0.1	0.1	0.1	0.6
Establish IRS continuous levy	--	0.4	0.4	0.4	0.3	0.2	1.6
NTSB aviation accident fees	--	*	*	*	*	*	*
Alien labor certification fee	--	*	*	*	*	*	0.2
FDA user fees	--	0.2	0.2	0.2	0.2	0.2	1.0
HCFA survey and certif. fee	--	*	*	*	*	*	*
Increase employee contrib CSRS/FERS	--	--	0.2	0.4	0.6	0.6	1.8
Adjust federal employee pay raise	--	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0
Subtotal, revenue raisers, extenders	3.0	11.7	15.4	16.6	17.2	18.7	82.5
Net Revenue Proposals	1.6	-7.0	-1.4	-3.7	-5.5	-4.9	-20.8

*Less than \$50 million

BUDGET PROCESS ISSUES

The President's budget includes a number of budget process changes. These changes include a **trigger** to sunset tax cuts and make across-the-board spending cuts to achieve balance in 2002 under the Congressional Budget Office's assumptions, the restoration of **\$6.7 billion to the pay-as-you-go scorecard**, a proposed **joint budget resolution**, the extension of the **Budget Enforcement Act**, and a number of proposed **cap adjustments**.

The Clinton Administration proposes a **trigger** that would sunset the President's proposed tax reductions and impose an estimated 2.5 percent across-the-board reduction in all spending except Social Security in order to balance the budget by 2002 using the Congressional Budget Office's estimates.

The President's budget would restore **\$6.7 billion in savings on the pay-as-you-go scorecard**. This \$6.7 billion restoration, or credit, is needed to pay for the President's proposed mandatory spending and tax proposals that will increase the deficit in 1997 and 1998. Absent this change, the President's budget would cause a \$2.9 billion sequester in non-exempt mandatory programs such as Medicare, student loans, and agriculture.

The Administration proposes to offset the cost of this **\$6.7 billion pay-as-you-go credit** by reducing the 1997 discretionary spending caps by \$6.7 billion. This reduction will have no impact on actual discretionary spending. Current discretionary spending is \$29 billion in budget authority and \$12 billion in outlays below the statutory caps for 1997 and there are only 8 months left in fiscal year 1997. Moreover, the Congress established much lower discretionary spending caps in the budget resolution and current spending already exceeds Congress' spending limits by \$10 billion in budget authority and \$8 billion in outlays.

The President proposes a **joint budget resolution**, which would require the President's approval of the budget resolution. Currently, the budget resolution takes the form of a concurrent resolution, which is effective once adopted by both Houses of Congress. A concurrent resolution on the budget does not require the President's approval and the President is not directly bound by it. The President also proposes that the joint budget resolution set spending, revenue, deficit, debt levels, and the economic assumptions underlying the budget.

The President's budget would extend through 2002 the **Budget Enforcement Act's (BEA) discretionary spending caps and the pay-as-you-go** requirement for revenue and entitlement legislation. The BEA established in 1990 two independent enforcement regimes: budget authority and outlay caps on discretionary spending and a "pay-as-you-go" requirement for revenue and entitlement legislation. Both of these regimes are enforced by OMB through sequester orders. If the discretionary caps are exceeded, OMB sequesters non-exempt discretionary accounts to bring

spending within the caps. For pay-as-you-go, if entitlement or revenue legislation causes a deficit increase, OMB sequesters non-exempt mandatory spending to eliminate the deficit increase.

The Administration's budget includes a number of proposed **adjustments to the discretionary spending caps**. The largest proposed adjustment is for legislation that either increases or reduces user fees. Currently, under the BEA, any changes in spending or user fees made by appropriations legislation is scored against the discretionary caps and any changes made by all other legislation is scored against pay-as-you-go. For authorization legislation that changes user fees, the change in receipts is scored for pay-as-you-go purposes and cannot be used to offset discretionary spending.

The BEA also provides that appropriations legislation will be held accountable for changes in user fees or entitlement programs. As a result, if an appropriations measure reduces user fees or expands an entitlement program, these increased costs are scored to the appropriations measure and counted in determining whether the bill complies with the discretionary caps. Similarly, if an appropriations measure increases user fees or reduces entitlement funding, the savings from these changes can be used to meet the discretionary caps and not scored for pay-as-you-go purposes.

The President's budget proposes an adjustment to the discretionary caps for authorization legislation that changes user fees that are intended to pay for discretionary programs. For such legislation, the President's budget proposes to provide an adjustment to the discretionary spending caps that is equal to the change in the level of user fee receipts. Therefore, if an authorization bill increases user fees that are designed to offset discretionary spending, the savings from this legislation will not be available for pay-as-you-go. Instead, the President's budget proposes that the spending caps be adjusted by the amount of the savings from the user fees to make room for higher discretionary spending.

Other proposed cap adjustments and scoring changes include:

- ▶ **\$5.8 billion adjustment in 1998 for emergency spending.** The President's budget proposes a \$5.8 billion contingent emergency appropriation, which represents an amount equal to the 10 year historical average for emergency funding. This funding would become available for obligation and expenditure, and the caps would be adjusted upward, if the President determined that the funds were needed for emergency requirements. Under the BEA, the caps are adjusted upwards to fully accommodate higher emergency spending. While this proposal is consistent with the BEA, the \$5.8 billion in additional annual spending is not reflected in the President's proposed spending totals although it would increase spending and the deficit.
- ▶ **\$89 million adjustment for 1998 state unemployment operations.** The adjustment is intended to accommodate additional appropriations for eligibility reviews and tax audits that are expected to generate savings in the unemployment program.

- ▶ **Other proposed adjustments** regarding the Federal Financial Management Service and the Vaccine Injury Compensation Fund.
- ▶ **A change in the asset scoring rule.** The BEA provides that proceeds from asset sales are not be taken into account in determining compliance with discretionary spending caps or pay-as-you-go. The President proposes to modify this scoring rule to allow asset sales to be taken into account if they would not cost the federal government over the long-term.

APPENDIX

Summary Tables

Table 1:
1997 RESCISSIONS AND DEFERRALS IN THE PRESIDENT'S REQUEST

Table 2:
SUMMARY BY FUNCTION OF THE PRESIDENT'S 1998 BUDGET

Table 3:
COMPARISON OF 1998 PRESIDENT'S REQUEST WITH CURRENT SERVICES

Table 4:
TAX REVENUES BY SOURCE IN THE PRESIDENT'S 1998 BUDGET

REQUESTS FOR 1997

As shown in the table below, the President has proposed supplemental appropriations and transfers of \$3.0 billion in budget authority and \$2.5 billion in outlays for 1997. Of this amount, \$2.1 billion in budget authority and \$1.0 billion in outlays are designated emergency spending and \$0.8 billion in budget authority and outlays are for mandatory programs. Rescissions and other offsets totalling \$5.3 billion in budget authority and \$2.4 billion in outlays were also proposed. A supplemental advance appropriation of \$921 million in 1999 is also requested for arrearage payments to the United Nations.

TABLE 1: SUPPLEMENTALS, TRANSFERS, AND RESCISSIONS

(\$ Millions)

	Budget Authority	Outlays
Supplementals and transfers:		
Child nutrition programs	6	6
Women, infants, and children (WIC) feeding program	100	91
DOD overseas contingency operations fund <u>a/</u>	2,006	1,495
POW payments	20	5
Reserve mobilization income insurance fund <u>a/</u>	72	72
Drug elimination grants for low-income housing	30	---
Coast Guard retired pay <u>b/</u>	4	4
Federal-aid highways	---	47
Veterans compensation and pensions <u>b/</u>	753	753
National Transportation Safety Board	20	18
Postal Service	5	5
 Total supplementals	 3,016	 2,496
 Rescissions and reductions:		
Emergency food assistance program	---	-6
DOD-wide savings proposals	-4,800	-2,282
Corps of Engineers, construction	-50	-30
HOPE grants	-30	-6
One-stop career centers	---	-45
PL 480	-50	-28
Army Reserve personnel	-20	-18
DOD operations and maintenance	-10	-7
National Guard and Reserve equipment	-42	-7
Annual contributions for assisted housing	-250	-10
 Total rescissions	 -5,252	 -2,439

a/ Designated emergency spending.

b/ Mandatory supplementals.

**TABLE 2: SUMMARY BY FUNCTION OF THE PRESIDENT'S
1998 BUDGET**
(\$ Billions)

Function		1997	1998	1999	2000	2001	2002
050: Defense	BA	262.3	265.3	269.2	275.0	281.5	289.1
	OT	267.2	259.4	261.4	267.2	268.0	273.2
150: International Affairs	BA	17.4	21.8	18.1	17.4	17.6	17.9
	OT	14.8	14.9	15.9	15.2	15.3	15.5
250: Science & Technology	BA	16.7	16.5	16.5	16.3	16.3	16.3
	OT	16.6	16.5	16.4	16.2	16.1	16.1
270: Energy	BA	1.0	1.9	1.2	2.1	1.3	-0.1
	OT	2.1	2.3	1.3	2.0	1.6	-0.4
300: Natural Resources	BA	22.1	23.7	23.4	22.9	22.8	22.8
	OT	22.8	22.3	22.6	23.1	23.2	23.0
350: Agriculture	BA	11.4	12.1	11.8	11.3	10.3	10.1
	OT	10.3	12.3	11.8	11.2	10.0	9.8
370: Commerce & Housing	BA	12.8	832	10.7	16.7	16.6	18.0
	OT	-8.8	3.4	6.3	12.6	73	8.1
400: Transportation	BA	43.8	44.2	42.9	43.0	43.3	43.0
	OT	39.3	39.3	39.4	39.3	39.4	39.2
450: Community Development	BA	10.4	11.3	8.8	8.0	8.1	8.0
	OT	12.8	11.4	11.4	9.6	8.4	8.0
500: Education & Training	BA	53.9	64.7	62.4	64.0	64.3	64.9
	OT	51.3	56.2	61.7	63.2	63.9	62.8
550: Health	BA	130.1	133.8	145.1	152.1	159.8	165.4
	OT	127.6	138.2	145.1	152.0	159.6	165.3
570: Medicare	BA	194.1	206.9	220.0	229.2	245.8	263.7
	OT	194.3	207.1	219.6	229.3	246.0	263.2

Function		1997	1998	1999	2000	2001	2002
600: Income Security	BA	232.6	239.4	254.8	268.7	273.5	285.2
	OT	238.9	247.5	256.4	266.2	269.3	280.0
650: Social Security	BA	367.3	385.8	403.6	422.8	443.1	465.0
	OT	367.7	384.3	402.0	421.1	441.2	463.0
700: Veterans Benefits	BA	39.4	41.2	41.7	42.2	42.7	43.2
	OT	39.7	41.0	41.9	43.9	41.2	43.4
750: Administration of Justice	BA	23.8	24.9	25.6	24.8	25.2	25.9
	OT	20.8	24.2	25.9	26.4	26.1	26.0
800: General Government	BA	12.9	13.6	13.3	13.0	12.9	13.1
	OT	13.1	12.9	13.2	13.6	13.0	13.0
900: Net Interest	BA	247.4	249.9	251.8	248.2	245.0	238.8
	OT	247.4	249.9	251.8	248.2	245.0	238.8
920: Allowances	BA	---	---	---	---	---	---
	OT	---	---	---	---	---	---
950: Undistributed Offsetting Receipts	BA	-46.5	-55.6	-43.5	-46.0	-50.1	-68.0
	OT	-46.5	-55.6	-43.5	-46.0	-50.1	-68.0
Total	BA	1,652.9	1,709.5	1,777.4	1,831.7	1,880.0	1,922.3
	OT	1,631.0	1,687.5	1,760.7	1,814.4	1,844.5	1,879.7
Revenues		1,505.4	1,566.8	1,643.3	1,727.3	1,808.3	1,896.7
Deficit/Surplus		-125.6	-120.6	-117.4	-87.1	-36.1	17.0

COMPARISON OF 1998 PRESIDENT'S REQUEST WITH CURRENT SERVICES

(\$ Billions)

Function	<u>1997 Current Services</u>		<u>1998 Current Services</u>		<u>1998 President's Request</u>		1998 President's Request compared to:			
							<u>1997 Current Services</u>		<u>1998 Current Services</u>	
	BA	OT	BA	OT	BA	OT	BA	OT	BA	OT
050: Defense	265.1	267.9	272.9	264.7	265.3	259.4	+0.2	-8.5	-7.6	-5.3
150: International Affairs	17.4	14.8	17.6	14.8	21.8	14.9	+4.4	+0.1	+4.2	+0.1
250: Science & Technology	16.7	16.6	17.1	17.0	16.5	16.5	-0.2	-0.1	-0.7	-0.5
270: Energy	1.0	2.1	1.8	2.1	1.9	2.3	+0.9	+0.2	+0.1	+0.2
300: Natural Resources	22.2	22.8	22.9	22.3	23.7	22.3	+1.5	-0.5	+0.8	+0.1
350: Agriculture	11.5	10.3	12.2	12.5	12.1	12.3	+0.6	+2.0	-0.1	-0.1
370: Commerce & Housing	12.8	-8.8	8.7	3.8	8.3	3.4	-4.5	+12.2	-0.5	-0.5
400: Transportation	43.8	39.2	45.1	39.3	44.2	39.3	+0.4	+0.1	-0.9	-0.1
450: Community Development	10.3	12.6	9.9	11.1	11.3	11.4	+1.0	-1.2	+1.4	+0.3
500: Education & Training	54.2	51.7	57.1	54.9	64.7	56.2	+10.5	+4.5	+7.6	+1.3
550: Health	130.1	127.6	130.4	134.8	133.8	138.2	+3.7	+10.6	+3.3	+3.4
570: Medicare	194.1	194.3	211.1	211.4	206.9	207.1	+12.8	+12.8	-4.3	-4.3
600: Income Security	232.1	238.2	237.9	245.2	239.4	247.5	+7.3	+9.3	+1.5	+2.3
650: Social Security	367.3	367.7	386.1	384.6	385.8	384.3	+18.5	+16.7	-0.3	-0.2
700: Veterans Benefits	39.4	39.6	41.7	41.6	41.2	41.0	+1.8	+0.4	-0.5	-0.7
750: Administration of Justice	23.8	20.8	24.1	23.6	24.9	24.2	+1.1	+3.4	+0.7	+0.7
800: General Government	12.9	13.1	13.1	13.1	13.6	12.9	+0.7	-0.2	+0.5	-0.3
900: Net Interest	247.6	247.6	249.9	249.9	249.9	249.9	+2.3	+2.3	-0.1	-0.1
920: Allowances	---	---	---	---	---	---	---	---	---	---
950: Undistributed Offsetting Receipts	-46.5	-46.5	-53.3	-53.3	-55.6	-55.6	-9.1	-9.1	-2.3	-2.3
Total Spending	1,655.7	1,631.5	1,706.5	1,693.4	1,709.5	1,687.5	+53.8	+56.0	+3.1	-5.9
Revenues		1,503.8		1,573.8		1,566.8		+63.0		-7.0
Deficit		-127.7		-119.5		-120.6		-7.0		+1.1

TABLE 4: TAX REVENUES BY SOURCE IN THE PRESIDENT'S 1998 BUDGET
(\$ billions)

	1996	1997	1998	1999	2000	2001	2002
Individual income taxes	656.4	672.7	691.2	721.6	755.6	795.2	839.9
Corporate income taxes	171.8	176.2	189.7	199.6	212.0	220.5	227.8
Social insurance taxes	509.4	535.8	557.8	585.2	614.4	642.2	673.1
Excise taxes	54.0	57.2	61.2	64.5	64.9	66.2	67.4
Estate and gift taxes	17.2	17.6	18.8	20.0	21.4	22.9	24.6
Customs duties	18.7	17.3	18.3	18.5	19.6	20.5	22.0
Miscellaneous receipts	25.5	28.6	29.8	34.0	39.4	40.8	42.0
Total receipts	1,453.0	1,505.4	1,566.8	1,643.3	1,727.3	1,808.3	1,896.7